Supreme Court, U.S.
FILED

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No. _____

In The

Supreme Court of the United States

BRUCE MAGERS, TRUSTEE IN BANKRUPTCY FOR BONDS DISTRIBUTING COMPANY, INC.,

Petitioner,

v.

DONALD R. BONDS, BONDS, INC., and WILLIAM L. MILLS, III,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether, under applicable North Carolina law, the complete omission of a creditor's address from a UCC-1 financing statement constitutes a defect that is fatal to the perfection of the creditor's security interest in a debtor's assets?

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PETITION FOR WRIT OF CERTIORARI

Bruce Magers, Trustee in Bankruptcy for Bonds Distributing Company, Inc. (hereinafter the "Petitioner"), respectfully requests this Court to issue a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Fourth Circuit that validated the unperfected security interest of Donald R. Bonds in this case.

OPINIONS BELOW

The opinion of the Court of Appeals for the Fourth Circuit (App., *infra*, 1-16) is not officially reported, but can be located at 2002 WL 1492249. The opinion of the United States District Court for the Middle District of North Carolina (App., *infra*, 21-22) is unreported. The opinion of the United States Bankruptcy Court for the Middle District of North Carolina (App., *infra*, 23-67) is not officially reported, but can be located at 2000 WL 33673768.

JURISDICTION

The Court of Appeals entered its judgment on July 15, 2002. An order denying the Petitioner's Petition for a Rehearing En Banc or, in the Alternative, a Panel Rehearing was entered by the Court of Appeals on August 9, 2002. (App., *infra*, 68-69). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

North Carolina General Statute § 25-9-402(1):

> A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. . . .

North Carolina General Statute § 25-9-402(8):

> A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading.

STATEMENT OF THE CASE

A. The Facts

The undisputed facts in this case are as follows:

Bonds Distributing Company, Inc. ("BDI") was incorporated under the laws of the State of North Carolina in 1976. From the date of incorporation through November 7, 1995, Donald R. Bonds (hereinafter "Bonds") was the president, sole director, and sole shareholder of BDI. The primary business of BDI involved the operation of a wholesale outlet for small engine parts for outdoor power equipment such as chain saws, lawnmowers, edgers and the like. Bonds managed the business operations of BDI until November 1995.

In the summer of 1995, Bonds negotiated with Stephen H. Young (hereinafter "Young") concerning the sale of BDI to Young. On November 7, 1995, Bonds, Young, and BDI entered into a Stock Purchase Agreement evidencing their agreement to a transaction in which, among other things, 10% of Bonds' stock in BDI was sold to Young for a purchase price of $161,121.10; approximately 90% of Bonds' stock in BDI was redeemed by BDI in exchange for a $1,451,000.00 promissory note payable by BDI to Bonds; BDI granted Bonds a security interest in all of the assets of BDI to secure the payment of the promissory note; Young granted Bonds a security interest in the BDI shares that he acquired from Bonds; and Bonds retained one share of stock in BDI and continued as a director of BDI.

In an effort to perfect his security interest in the assets of BDI, on the date of the closing of the transaction, Bonds filed UCC-1 financing statements with the Office of the Register of Deeds of Cabarrus County and the Office of the North Carolina Secretary of State. The UCC-1 financing statement filed with the North Carolina Secretary of State completely omitted the address of Bonds as the secured party.

Following the closing of the sale transaction, Young assumed control of BDI and began managing its business operations. In July of 1997, BDI defaulted on its payments to Bonds under the $1,451,000.00 promissory note. Bonds initiated collection efforts against BDI, which included a foreclosure sale that was held on August 21, 1997. The only bid at the sale was submitted by Bonds, Inc., a new corporation formed by Bonds approximately one week before the foreclosure sale. The bid amount was $1,484,391.11.

Following the foreclosure sale, Bonds, Inc. assumed control of BDI's assets, including the inventory that BDI owned at the time of the foreclosure sale. Bonds, Inc., under the management of Bonds, thereafter conducted a business that was virtually identical to the business that had been operated by BDI prior to the foreclosure sale.

B. The Proceedings Below

On October 30, 1997, an involuntary petition under Chapter 7 of the Bankruptcy Code was filed against BDI. The Bankruptcy Court entered an Order for Relief under Chapter 7 of the Bankruptcy Code on December 16, 1997. The Petitioner is the duly appointed Chapter 7 Trustee herein.

On August 14, 1998, the Petitioner filed an adversary complaint against Bonds and Bonds, Inc., requesting, among other things, an order and judgment of the Bankruptcy Court annulling the purported transfer of a security interest in BDI's assets to Bonds and the purported sale of BDI's assets to Bonds, Inc. at foreclosure. The basis of jurisdiction over this adversary proceeding by the Bankruptcy Court was 28 U.S.C. § 157(b).

On summary judgment, the Bankruptcy Court determined that the complete omission of Bonds' address from the UCC-1 financing statement filed with the North Carolina Secretary of State was fatal to the perfection of Bonds' security interest in the assets of BDI. Accordingly, the Bankruptcy Court determined that the Petitioner, as trustee, had superior rights to the foreclosed assets pursuant to the "strong-arm" powers of 11 U.S.C. § 544. Citing Section 550 of the Bankruptcy Code, the Bankruptcy Court ordered that Bonds and Bonds, Inc. pay the fair

market value of those assets to the Petitioner. The District Court affirmed the decision of the bankruptcy court with respect to the invalidity of the UCC-1 financing statement. A jury determined that the value of the foreclosed assets was $1,400,000 and on July 31, 2001, the District Court entered an order and judgment directing Bonds and Bonds, Inc. to pay that amount to the Petitioner. (App., *infra*, 17-20). The Fourth Circuit reversed the decisions of the Bankruptcy Court and the District Court.

In its unpublished opinion, the Court of Appeals reversed the decision of the Bankruptcy Court and the District Court (two federal judges sitting in North Carolina), holding that, under North Carolina law, the complete omission of Bonds' address from the UCC-1 financing statement filed with the North Carolina Secretary of State was not fatal to the perfection of Bonds' security interest in the assets of BDI. The Court of Appeals opined that Bonds did not need to comply with the express statutory directive in North Carolina Gen. Stat. § 25-9-402(1) that "a financing statement is sufficient if it . . . gives an address of the secured party from which information concerning the security interest may be obtained."[1] Instead, the Court

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[1] N.C. Gen. Stat. § 25-9-402(1) provides in pertinent part as follows:

> A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an *address of the secured party* from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. . . .

(emphasis added). Comment One to Section 25-9-402(1) states that "[s]ubsection (1) sets out the *simple formal requisites* of a financing

(Continued on following page)

of Appeals determined that the substantial compliance standard of North Carolina Gen. Stat. § 25-9-402(8)[2] trumps the express requirements of subsection 402(1), and that a financing statement that completely omits one or more of the statutory requisites of subsection 402(1) is sufficient so long as it serves the purpose of providing notice of the purported security interest to potential records searchers.

REASONS FOR GRANTING A WRIT OF CERTIORARI

Certiorari should be granted for two reasons. First, the decision below is in direct conflict with the decision by the Ninth Circuit in *In re Softalk Publishing Co., Inc.*, 856 F.2d 1328 (9th Cir. 1988), that all of the elements of Section 9-402(1) of the Uniform Commercial Code must be substantially complied with before a security interest will be properly perfected. Second, the decision below is erroneous under applicable North Carolina statutes and precedent.

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statement under this Article. These requirements are: (1) signature of the debtor; (2) addresses of both parties; (3) a description of the collateral by type or item." (emphasis added).

[2] N.C. Gen. Stat. § 25-9-402(8) provides in pertinent part as follows:

> A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading.

I. There is a split of authority between the Ninth Circuit and the Fourth Circuit as to the proper interpretation of Section 402(1) of Article 9 of the Uniform Commercial Code

In *In re Softalk Publishing Co., Inc.*, 856 F.2d 1328 (9th Cir. 1988), the Ninth Circuit faced substantially the same issue as the Fourth Circuit did in this case. In *Softalk Publishing*, the financing statement at issue failed to contain a description of the secured party's collateral. Analyzing Section 9-402 of the Uniform Commercial Code as adopted by the State of California, which is identical to N.C. Gen. Stat. § 25-9-402, the Ninth Circuit wrote:

> Since the UCC has reduced the formal requisites of a financing statement to a minimum, there can be no acceptable excuse for failure to comply with its provisions. . . . [Subsection 9402(8)] allows a financing statement to contain minor errors that are not seriously misleading. Before subsection 9402(8) will save a financing statement that contains errors, however, that financing statement must substantially comply with the remainder of section 9402. *A financing statement that ignores even the few minimal mandatory requisites of section 9402 (here, by omitting the statement of collateral) is not "substantially complying" with section 9402 for the purposes of subsection 9402(8).*

Id. at 1331 (emphasis added) (citations omitted).

As recognized by the *Softalk Publishing* court, and as determined by the Bankruptcy Court[3] and the District Court in this case, substantial compliance is not a substitute for noncompliance. The requirements of Section 402(1) are plain and simple. The complete failure to comply with each of the elemental requirements of Section 402(1) renders a financing statement invalid. The Ninth Circuit recognized this truism, but the Fourth Circuit did not. This petition for a writ of certiorari should be granted for that reason.

II. The Decision of the Court of Appeals Completely Ignores the Plain Language and the Commentary to Applicable North Carolina Statutes and Misapplies Applicable North Carolina Precedent

Pursuant to N.C. Gen. Stat. § 25-9-302(1), in order to perfect a security interest in inventory, equipment, and accounts, a financing statement must be filed. N.C. Gen.

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[3] In its Memorandum Opinion, the bankruptcy court wrote:

> The complete omission of the secured creditor's address from a financing statement involves a failure to comply with one of the statutory requirements under G.S. § 25-9-402(1), which may not be passed off as a minor error. Perhaps, from the standpoint of semantics, it is debatable whether the total absence of information "mis" leads; however, this is immaterial where, as in the present case, the omitted information is specifically required by the statute. . . . [T]he complete omission of one of the basic elements of an effective financing statement constitutes noncompliance with G.S. § 25-9-402(1), not substantial compliance, and renders a secured creditor's security interest unperfected.

(App., *infra*, 45).

Stat. § 25-9-402(1) lists the "formal" requisites for a financing statement. Under that statute, a financing statement is sufficient if it "gives the names of the debtor and the secured party, is signed by the debtor, gives an *address of the secured party* from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral." (emphasis added).

As stated in the Amended Official Comment to N.C. Gen. Stat. § 25-9-402, "[s]ubsection (1) sets out the simple *formal requisites* of a financing statement under this Article. These requirements are: (1) signature of the debtor; (2) addresses of both parties; (3) a description of the collateral by type or item." (emphasis added).

In an attempt to steer away from overly technical filing requirements, N.C. Gen. Stat. § 25-9-402(8) directs that "[a] financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading." The North Carolina Supreme Court has recognized that Section 25-9-402 "adopts a system of notice filing," and the rule of substantial compliance in subsection (8) of the provision evidences the notice function of the filing. *Evans v. Everett*, 183 S.E.2d 109, 112 (N.C. 1971). *See also In re Matter of Southern Sup. Co. of Greenville, N.C., Inc.*, 405 F. S pp. 20, 22 (E.D.N.C. 1975) ("One of the policies of [Article 9] is to simplify formal requisites and filing requirements and is designed to discourage the fanatical and impossibly refined reading of statutory requirements in which courts have occasionally indulged themselves.").

As the language of Section 25-9-402(1) indicates, the purpose of requiring the address requirement of the secured party in a financing statement is to enable credit searchers to contact the secured party for the purpose of obtaining information as to the breadth of the secured party's security interest and security agreement. *Accord Mid-American Dairymen, Inc. v. Newman Grove Cooperative Creamery Co., Inc.*, 214 N.W.2d 18, 23 (Neb. 1974). Accordingly, if a financing statement lists a partial address (such as city and state but no street address), which would enable a credit searcher to locate the secured party, then the financing statement, although deficient, substantially complies with the requirement of Section 25-9-402(1). For example, in the North Carolina case of *E-B Grain Co. v. Denton*, 325 S.E.2d 522, 557 (N.C. App. 1985), the North Carolina Court of Appeals determined that the secured party's address, listed as "Whitakers, N.C. 27891," was not so incomplete as to be misleading or as to interfere with the notice function of the filing, and that the deficient address substantially complied with the requirements of N.C. Gen. Stat. § 25-9-402(1). *Id.* at 526.

Despite the general rule of liberality found in Section 9-402(8) and the courts' recognition that a partial address may pass muster under the rule of substantial compliance, the law is well-settled that when there is no attempt whatsoever to comply with Section 9-402(1), and the address of the secured party or the debtor is totally omitted from the financing statement, the error, even if not misleading, constitutes noncompliance with the terms of

the statute, thereby defeating perfection of the creditor's security interest.[4]

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[4] *See In re Keefer*, 26 B.R. 597 (Bankr. D. Idaho 1983) (financing statement invalid due to lack of debtor's address); *In re Smith*, 205 F. Supp. 27, 28-29 (E.D. Pa. 1962) (omission of debtor's address from financing statement, as a matter of law, prevents such a statement from perfecting a security interest); *In re Permian Anchor Services, Inc.*, 649 F.2d 763, 766 (10th Cir. 1981) ("There are no degrees of invalidity. A financing statement is invalid because of a lack of a debtor's signature as it is for lack of the debtor's address."); *Whitworth v. Krueger*, 558 P.2d 1026, 1035 (Idaho 1976) ("The address requirement is strictly construed because the potential creditor must be able to know where to go to get further information. . . . A financing statement is insufficient when it does not contain the address of the creditor."); *In re L & K Transportation Co., Inc.*, 8 B.R. 921, 922 (Bankr. D. Mass. 1981) (complete absence of the debtor's address is not the type of minor error contemplated by § 402(8) unless the debtor is so well known that there could be no question as to its identity and address); *Cushman Sales and Service of Nebraska, Inc. v. Muirhead*, 268 N.W.2d 440, 444 (Neb. 1978) (financing statement fatally defective where address of secured creditor omitted); *Starvell-Paterson Finance Company v. May*, 422 P.2d 366, 369 (N.M. 1967) ("If the secured party's address does not appear it would be an undue burden on the person seeking such information to find him. The filing system will perform its intended function only if the secured party substantially complies with the requirements of § 9-402(1)."); *Guardian State Bank v. Lambert*, 834 P.2d 605, 607 (Utah Ct. App. 1992) ("[C]ase law has established that [the] substantial compliance provision is not all encompassing. It pertains to minor errors in the contents of the statement and does not relate to one of the formal requisites of a financing statement such as the signatures of the secured parties."); *In re HGS Technical Associates, Inc.*, 14 UCC Rep Serv. 237 (Bankr. E.D. Tenn. 1972) (lack of address of the debtor caused financing statement to be ineffective – "[T]he courts in the guise of interpretation should not ignore express requirements of the Code as to the content of the financing statement. Nor should the Code requirements be scuttled on a plea that they are loose and relaxed."); *In re Copper King Inn, Inc.*, 918 F.2d 1404, 1407 (9th Cir. 1990) (the omission of the secured creditor's name from a financing statement is not a minor error and renders the financing statement ineffective); *In re*

(Continued on following page)

An analysis of the North Carolina statutes and cases reveals that, with regard to each element of Section 25-9-402(1), there must be at least some attempt to meet that element. An examination of each of the statutory elements makes that clear.

First, Section 25-9-402(1) mandates that the financing statement list the name of the debtor. It is axiomatic that a financing statement is fatally flawed if it omits the name of the debtor. Although no North Carolina courts have expressly stated that the failure to list the debtor's name renders a financing statement ineffective, two federal courts sitting in North Carolina have so ruled. *See In re Seventeen S. Garmet Co.*, 145 B.R. 511 (E.D.N.C. 1992); *In re Environmental Aspecs, Inc.*, 235 B.R. 378 (E.D.N.C. 1999). Similarly, revised Article 9 Section 25-9-502(a) retains the requirement that the debtor's name be listed on a financing statement, confirming the fact that the name of the debtor is an essential requisite to a valid financing statement.

Second, Section 25-9-402(1) requires that the financing statement contain the name of the secured party. Although there is no North Carolina case on point, the fact that the name of the secured party is an essential requirement of an effective financing statement under former Section 25-9-402 is confirmed by the adoption of revised Article 9 Section 25-9-502(a), which contains the same requirement.

Softalk Publishing Co., 856 F.2d 1328, 1331 (9th Cir. 1998) (financing statement that does not identify the collateral is ineffective).

Third is the requirement that the financing statement contain the signature of the debtor. *Provident Finance Co. v. Beneficial Finance Co.*, 245 S.E.2d 510 (N.C. Ct. App. 1978), unequivocally establishes that the signature of the debtor is imperative to the validity of a financing statement. In *Provident Finance*, the debtor's wife, and not the debtor, signed the subject financing statement. The court held that the financing statement was invalid and that a financing statement must contain the signature of the debtor. *See also In re Lea Lumber & Plywood, LLC*, 266 B.R. 342 (E.D.N.C. 2001) (under North Carolina law, financing statement is void, and is ineffective to perfect creditor's security interest, where debtor's signature is completely absent).

Fourth is the requirement that the financing statement contain a description of the collateral. There is no North Carolina case on point, but a financing statement cannot provide statutory notice to records searchers if the financing statement does not list the purported collateral. Revised Article 9 § 25-9-502(a)(3) retains the requirement that a financing statement list the collateral covered by the financing statement.

Fifth is the requirement that the financing statement contain the address of the debtor. The North Carolina Court of Appeals decision in *E-B Grain Co. v. Denton*, 325 S.E.2d 522 (N.C. App. 1985), establishes that at least some attempt to comply with this statutory element is necessary to meet the substantial compliance standard. In *E-B Grain*, the debtor listed its mailing address on a financing statement as "Whitakers, N.C. 27891." *Id.* at 527. The court wrote: "We think that the debtors' mailing address as shown on Exhibit 64 is *not so incomplete* as to be misleading or as to interfere with the notice function of the filing."

Id. (emphasis added). The natural corollary of the court's statement is that a wholly incomplete address – no address listed at all – is misleading and does interfere with the notice function of a financing statement. If a debtor's address was not an essential requirement under Section 25-9-402, the question in *E-B Grain*, of whether the debtors' address was "misleading" would have been a non-issue – the court would have simply concluded that it does not matter what information, if any, a financing statement contains concerning a debtor's address. However, the *E-B Grain* court did not reach such a conclusion, establishing that an effective financing statement must contain at least some attempt to list the debtor's address.

Sixth is the requirement that a financing statement contain the address of the secured party. There is no definitive statement by the North Carolina courts on this issue. However, the newly adopted recently revised Article 9, and its commentary, make clear that the address of the secured party is a prerequisite under Section 25-9-402(1).

Article 9 of the Uniform Commercial Code was amended by the North Carolina legislature, effective July 1, 2001. Pursuant to Revised Article 9 Section 25-9-520(a), the secured party's address is a mandatory requirement of a UCC financing statement. However, pursuant to Revised Section 25-9-520(c), if the faulty financing statement evades the filing officer's notice and is filed of record despite Revised Section 25-9-520(a)'s directive to the contrary, then the financing statement is fully effective despite the omission of the secured party's address. Comment 5 to Revised Section 25-9-516 confirms this fact, providing that: "Under subsection (b)(4) and Section 9-520(a), the lack of a mailing address for the secured party of record requires the filing office to reject an initial

financing statement. The failure to include an address for the secured party of record no longer renders a financing statement ineffective."

Perhaps the most germane and instructive portion of Revised Article 9 and its Commentary is the foregoing sentence: "The failure to include an address for the secured party of record no longer renders a financing statement ineffective."[5] The only reasonable meaning of this statement is that under former Article 9 (Section 25-9-402(1)) the failure to include the address of the secured party did render the financing statement ineffective. Therefore, by adopting Revised Article 9 and its Comments, the North Carolina legislature confirmed that under Section 25-9-402(1) the lack of the secured party's address renders a financing statement invalid.[6]

In its decision, the Court of Appeals adopts a portion of Comment 5 to Section 25-9-516,[7] but completely omits any discussion of the unequivocal, concrete statement in the immediately preceding sentence of that same Comment that "[t]he failure to include an address for the secured party of record no longer renders a financing statement ineffective." The adoption by the Fourth Circuit of one sentence of Comment 5 cannot be reconciled with its disregard of the immediately preceding sentence that contradicts its ruling.

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[5] N.C. Gen. Stat. § 25-9-516, Commentary ¶ 5.

[6] *See also* N.C. Gen. Stat. § 25-9-502, Comment 4 (Under Revised Article 9, "the filing office must reject a financing statement lacking certain other information formerly required as a condition of perfection (*e.g.*, an address for the debtor or secured party.")).

[7] (App., *infra*, 11).

All of the above cases, statutes, and statutory commentary point to one inescapable conclusion – under North Carolina law, the six listed elements of a valid financing statement under Section 25-9-402(1) are not mere recommendations that can be ignored by the secured creditor or a court. Rather, as the Comment to Section 25-9-402(1) states, they are the "formal requisites" of a valid financing statement. The Court of Appeals' conclusion that there is no authority for the proposition that "in every instance there must be substantial compliance with each separate clause of the filing statute" is contradicted by the North Carolina cases, the statutory language, and the Comments to both former Article 9 and Revised Article 9. Moreover, there is no support or authority whatsoever for the proposition that one of the six formal requirements may be ignored.

Although the Court of Appeals states that "some omissions, in some situations, may be fatal to the validity of the document," the Court of Appeals does not list such situations. The reason is that North Carolina law, consistent with other states,[8] provides that the omission of any one of the six required elements of Section 25-9-402(1) renders a financing statement ineffective.

Could a financing statement omit the name of the debtor? Of course not. Otherwise the filing system fails completely. Could a financing statement omit a description of the collateral? Again, such a suggestion is absurd, as the UCC filing system serves to put the world on notice as to exactly which assets of a debtor are encumbered. Could a

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[8] *See* n. 4, *supra*.

financing statement omit the signature of the debtor? Arguably such an omission would not significantly hinder the notice function of the filing. Nonetheless, *Provident Finance*, *supra*, states that such an omission will not be tolerated. Could a financing statement omit the name of the secured party? Revised Article 9 Section 25-9-502(a) states that such an omission is not allowed. Could a financing statement omit the address of the debtor? Again, the clear answer is no under the precedent established by *E-B Grain*[9]. Common sense, applicable precedent, and revised Article 9 leave no doubt that none of the six elements of Section 25-9-402 can be omitted from a valid financing statement. In light of the unequivocal statements in the Comments to revised Article 9 that, under former Article 9, the lack of the secured party's address rendered the financing statement ineffective, a conclusion that the address of the secured party is not a prerequisite to perfection is erroneous.

In rationalizing its decision, the Court of Appeals compared this case to *E-B Grain*. The Court of Appeals wrote:

> The omission of an address does not "prevent" a person from ascertaining information about Bonds; the omission simply obligates the inquirer to go through an additional step. That was precisely what the North Carolina Court of Appeals authorized in *E-B Grain Co.* The debtor provided only a city, state and zip code. The creditor had to either track down a more complete address or make a different inquiry about

[9] *See* pp. 13-14, *supra*.

> the interest shown on the UCC filing. In this case, a telephone call to the office of the Register of Deeds for Cabarrus County would have been sufficient. A slightly more sophisticated researcher could have used existing databases for a name only search. Nothing more would have been necessary. . . . Therefore, from the perspective of providing notice, *E-B Grain Co.* is virtually indistinguishable from the case at bar.

(App., *infra*, 9-10).

The Court of Appeals overlooked the fact that the address at issue in *E-B Grain* was that of the debtor, and that the defendant/creditor had "regular business dealings with the debtor" and knew how to directly contact the debtor. *E-B Grain*, 325 S.E.2d at 527. Further, the evidence in that case demonstrated that the defendant/creditor did not check the county records and therefore could not have been prejudiced by the faulty filing. *Id.* There is no evidence in this case that creditors were not prejudiced by Bonds' faulty financing statement. For the Court of Appeals to conclude that "from the perspective of providing notice, *E-B Grain* is virtually indistinguishable from the case at bar"[10] is to misapply the rationale and holding of the *E-B Grain* court.

The Court of Appeals took the position that a financing statement is sufficient if all that is required of the record searcher in discerning the validity of the security interest is that he go through one additional step, that is, make a telephone call. (App., *infra*, 10). However, in

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[10] (App., *infra*, 10).

Provident Finance Co. v. Beneficial Finance Co., 245 S.E.2d 510 (N.C. Ct. App. 1978), the North Carolina Court of Appeals refused to impose such a burden on the record searcher and struck down the financing statement in that case. In *Provident Finance*, a husband was listed as the debtor on a UCC-1 financing statement, but the financing statement was signed by the debtor's wife. The court held that the financing statement was ineffective because the debtor did not sign the financing statement as required by Section 25-9-402(1). A record searcher in *Provident Finance* could have made a simple telephone call to inquire as to the existence and validity of the security interest. However, the North Carolina Court of Appeals refused to impose that additional burden on the record searcher. The financing statement was invalid on its face. The Court of Appeals' conclusion that the omission of an element of Section 25-9-402(1) is permissible if that omission "simply obligates the inquirer to go through an additional step" directly contradicts *Provident Finance* and is not supported by any North Carolina case or statute.

Lastly, the Court of Appeals stated that the recent bankruptcy court case of *In re Lea Lumber & Plywood, LLC*, 266 B.R. 342 (Bankr. E.D.N.C. 2001), supports the theory that non-misleading mistakes on a financing statement should not nullify a security interest when general notice is otherwise provided. (App., *infra*, 12). In *Lea Lumber*, the debtor was a limited liability company and the signature on the financing statement did not indicate that the signature was that of the managing member of the debtor. The bankruptcy court declined to invalidate the financing statement on this ground. However, the bankruptcy court also stated that the financing statement would have been void had no signature

appeared on the document. *Id.* at 348. Further, in examining the relationship between Section 9-402(1) and 9-402(8), the *Lea Lumber* court wrote:

> The court agrees with [the creditor] that [the UCC financing statement] gives clear notice of the bank's security interest to researchers and therefore is not seriously misleading. *This, however, begs the prior question of whether the defective signature is a minor error. If the error is not minor, the requirements of § 9-402(1) are not satisfied, and the financing statement is simply void. In this event, the substantially misleading analysis is immaterial and cannot salvage the ineffective financing statement.* Thus, the effectiveness of this financing statement turns on the sufficiency of the debtor's signature.

Id. at 345 (emphasis added).

Although the Court of Appeals is correct that the *Lea Lumber* court determined that the faulty financing statement provided adequate notice of the creditor's security interest on the public record, the Court of Appeals failed to recognize the court's additional statements that had the signature requirement been wholly omitted, the error would not be considered minor and, accordingly, the issues of notice and substantial compliance would be irrelevant. Likewise, the complete omission of Bonds' address on the financing statement in this case is a not a minor error under the express dictate of Section 25-9-402(1). Bonds' financing statement is void, and the question of notice and substantial compliance is immaterial.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

THOMAS W. WALDREP, JR.*
DANIEL C. BRUTON
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Counsel for Petitioner

**Counsel of Record*

UNPUBLISHED

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

In Re: BONDS DISTRIBUTING COMPANY, INCORPORATED, *Debtor.*	
BRUCE MAGERS, Trustee for Bonds Distributing Company, Incorporated, *Plaintiff-Appellee,* and WILLIAM L. MILLS, III, d/b/a The Mills Law Firm, *Third Party Defendant-Appellee,* v. BONDS, INCORPORATED, *Defendant-Appellant,* and DONALD R. BONDS, *Defendant & Third Party Plaintiff-Appellant.*	No. 01-2025

In Re: BONDS DISTRIBUTING COMPANY, INCORPORATED, *Debtor.*	)	
WILLIAM L. MILLS, III, d/b/a The Mills Law Firm, *Third Party Defendant-Appellant,*	)	
and	)	No. 01-2503
BRUCE MAGERS, Trustee for Bonds Distributing Company, Incorporated, *Plaintiff,*	)	
v.	)	
BONDS, INCORPORATED, *Defendant-Appellee,*	)	
and	)	
DONALD R. BONDS, *Defendant & Third Party Plaintiff-Appellee.*	)	

Appeals from the United States District Court
for the Middle District of North Carolina, at Durham.
Frank W. Bullock, Jr., District Judge.
(CA-01-80-1, BK-97-52130C-7W)

Argued: May 7, 2002

Decided: July 15, 2002

Before WIDENER and MICHAEL, Circuit Judges, and
C. Arlen BEAM, Senior Circuit Judge of the
United States Court of Appeals for the Eighth Circuit,
sitting by designation.

Reversed and remanded by unpublished per curiam opinion.

COUNSEL

ARGUED: Richard Stewart Gordon, Charlotte, North Carolina, for Appellants. Grover Gray Wilson, WILSON & ISEMAN, L.L.P., Winston-Salem, North Carolina; Thomas William Waldrep, Jr., BELL, DAVIS & PITT, P.A., Winston-Salem, North Carolina, for Appellees.

Unpublished opinions are not binding precedent in this circuit. See Local Rule 36(c).

OPINION

PER CURIAM:

Donald R. Bonds (Bonds), Bonds, Inc. and William L. Mills III (Mills) appeal from an order of the district court affirming a decision by the bankruptcy court which held that the absence of a creditor's address on a North Carolina UCC-1 financing statement prevented the perfection of a security interest. For the reasons outlined below, we reverse.

I.

Bonds owned and operated a distributor of small engine parts, Bonds Distributing Company, Inc. (BDI), for approximately nineteen years. In 1995, Bonds sold BDI to Steve Young, and Mills served as Bonds' attorney for the

transaction. It is undisputed that the agreement between Bonds and Young provided that at the closing of the sale on November 7, 1995, Young would pay Bonds $150,000 for ten percent of the outstanding shares of BDI. The remaining shares, minus a single share which Bonds retained, were to be redeemed by BDI. The redemption was seller-financed, meaning Bonds accepted a Stock Purchase Note from BDI in the amount of $1,451,000 (the net asset value of the remaining stock) for the surrender of his shares.

The Stock Purchase Note was secured by an agreement under which BDI granted Bonds a security interest in all of its assets. To perfect Bonds' security interest, UCC-1 financing statements were prepared and signed at the closing. Pursuant to the law then in effect, these financing statements were filed with the North Carolina Secretary of State and at the Office of the Register of Deeds for Cabarrus County. N.C. Gen.Stat. § 25-9-401(a)(c) (repealed 2001). The statement filed with the Secretary of State[1] failed to provide an address for Bonds as the secured party; however, the document was accepted and filed by the Secretary.

In July 1997, BDI defaulted on its payments to Bonds under the Stock Purchase Note. On August 21, 1997, Bonds proceeded to reacquire the assets of BDI through a foreclosure sale permitted by the agreement. The lone bid

[1] The evidence establishes that Bonds decided not to use his residence address on business-related documents so he rented a post office box the day after the closing. This new address was placed on the County filing by Mills and forwarded to Young's attorney for inclusion on the State filing. This was never done.

at the sale was made by Bonds, Inc., a separate company that Bonds formed, in the amount of $1,484,391.11.

Approximately two months after the foreclosure sale, an involuntary petition under Chapter 7 of the Bankruptcy Code was filed against BDI. An order for relief was entered in the bankruptcy court and Bruce Magers was named as Trustee. On August 14, 1998, the Trustee filed an adversary proceeding in the bankruptcy court asserting, among other things, that Bonds never acquired a perfected security interest in BDI's assets as a result of his failure to include an address on the UCC-1 financing statement filed with the Secretary of State. In addition to denying the Trustee's claim, Bonds filed a third-party complaint seeking indemnification from his attorney, Mills, based on a malpractice theory, for his failure to include the address on the financing statement.

Various motions for summary judgment were filed by the parties. The bankruptcy court entered an order granting partial summary judgment in favor of the Trustee on the defective security interest claim, finding as a matter of law that Bonds' security interest was invalid as a result of the omitted address. The bankruptcy court denied Mills' motion for summary judgment. The district court affirmed in all respects.

The bankruptcy court also determined that Bonds had a right to have a jury resolve the remaining issues in the case, many of which are not relevant to this appeal. The district court withdrew the bankruptcy reference so that a jury trial could proceed. A trial was held to determine, among other things, what damages were due to BDI from Bonds on the security interest claim. In addition, Bonds' third-party malpractice-indemnity claim against Mills was

submitted to the jury. The jury found that Bonds owed the Trustee $1,400,000 in damages. The jury assessed an identical amount against Mills under Bonds' malpractice claim. Mills filed several post-trial motions, all of which were denied.

Bonds appeals from the bankruptcy court's partial summary judgment order, affirmed by the district court, holding that the omission of an address from a financing statement prevents the perfection of a security interest. Mills also appeals that order, and, in addition, appeals from the denial of his post-trial motions on the malpractice claim. Because we conclude that the courts below erred in holding that Bonds failed to perfect his security interest, it is unnecessary for us to reach the merits of Mills' malpractice appeal.

II.

As indicated, the courts ruled as a matter of law that Bonds' security interest was invalid because his address did not appear on his UCC-1 financing statement filed with the Secretary of State. We review conclusions of law de novo. *In re Deutchman,* 192 F.3d 457, 459 (4th Cir. 1999).

The issue of whether North Carolina requires the address of a creditor to appear on a UCC-1 financing statement in order for it to perfect a security interest is a matter determined solely by looking to North Carolina law. *See Butner v. United States,* 440 U.S. 48, 54 (1979). It appears, however, that the North Carolina courts have never faced this precise issue. In the absence of controlling state law, our function is to predict how the Supreme

Court of North Carolina would decide the matter. *McNair v. Lend Lease Trucks, Inc.*, 95 F.3d 325, 328 (4th Cir. 1996).

The North Carolina statute that was in effect when the facts of this case unfolded[2] read, in pertinent part, as follows:

> (1) A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. . . . (8) A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading.

N.C. Gen.Stat. § 25-9-402.

The bankruptcy court concluded that Bonds' financing statement failed to meet the statutory requirement that the creditor provide an address. Bonds concedes this point, as he must, at least as to the state filing. In addition, the bankruptcy court reasoned that because Bonds' address was completely omitted, he did not substantially comply with the requirements of the statute and the omission could not be passed off as a "minor error." To support these conclusions, the bankruptcy court embarked on a thorough review of cases across the country interpreting similar

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[2] North Carolina revised the statutory requirements for filing financing statements, effective July 1, 2001. N.C. Gen. Stat. § 25-9-702(c).

statutory provisions, and predicted that the North Carolina Supreme Court would reject Bonds' financing statement. However, the bankruptcy court discussed only two North Carolina cases, *Evans v. Everett,* 183 S.E.2d 109 (N.C. Ct. 1971), and *E-B Grain Co. v. Denton,* 325 S.E.2d 522 (N.C. App. 1985).

As the bankruptcy court noted, *Evans* recognized that section 25-9-402 of the General Statutes of North Carolina "adopts a system of notice filing," and the substantial compliance language in the statute reflects the notice function of the filing. 183 S.E.2d at 112.

In *E-B Grain Co.,* the debtor listed its mailing address on the financing statement as "Whitakers, N.C. 27891." 325 S.E.2d at 527. The court held that although the information for the address was incomplete, the address was not misleading and did not "*interfere with the notice function of the filing.*" *Id.* (emphasis added). The bankruptcy court concluded *E-B Grain Co.* is different from the instant case because Bonds' financing statement provided no information regarding his address. The bankruptcy court reasoned that the complete omission of an address cannot be considered substantial compliance or a minor error because it fails to comply with an express statutory requirement. We disagree.

While the bankruptcy court is correct that Bonds' complete omission of his address cannot be considered substantial compliance with the single clause in the statute that requires the inclusion of the creditor's address, we think this takes too narrow a view of substantial compliance with the statutory section as a whole. Substantial compliance needs to be evaluated through the prism of the North Carolina Supreme Court's language in *Evans*

that the purpose of the filing statute is to provide notice. Here, the financing statement complied with virtually all of the stated requirements. It included the names of the debtor and the secured party, it was signed by the debtor, it provided a mailing address for the debtor, and it contained a statement indicating the type of collateral that was involved. Taken together, we think the information in the financing statement substantially complied with the statutory requirements. We have found no authority for the proposition implicitly advanced by the bankruptcy court that in every instance there must be substantial compliance with each separate clause of the filing statute, although we agree that some omissions, in some situations, may be fatal to the validity of the document.

Most importantly, the filed financing statement put future creditors on notice that Bonds had a security interest in BDI's assets. If an existing or potential creditor wanted to obtain more information concerning the secured transaction from the secured party, it could take the unremarkable step of tracking down Bonds, a man who had been in business in Cabarrus County for decades. The bankruptcy court reasoned that the omission of Bonds' address "prevents the financing statement from serving one of the purposes expressly stated in the statute, i.e., giving the location of the source from which 'information concerning the security interest may be obtained.'" *In re Bonds Distributing Co.*, No. 97-52130C-7W, 2000 WL 33673768, at *11 (Bankr. M.D.N.C. Mar. 31, 2000) (citation omitted). This statement, however, is factually incorrect. The omission of an address does not "prevent" a person from ascertaining information about Bonds; the omission simply obligates the inquirer to go through an additional step. That was precisely what the North Carolina Court of

Appeals authorized in *E-B Grain Co.* The debtor provided only a city, state and zip code. The creditor had to either track down a more complete address or make a different inquiry about the interests shown on the UCC filing. In this case, a telephone call to the Office of the Register of Deeds for Cabarrus County would have been sufficient.[3] A slightly more sophisticated researcher could have used existing databases for a name only search. Nothing more would have been necessary. This point is dramatized by noting that under the new North Carolina law a creditor's address is no longer a threshold requirement for the effectiveness of a financing statement. *See supra* note 2 and N.C. Gen.Stat. § 25-9-502. Professors White and Summers state that "[t]he omission of addresses from [revised Article 9] is a statement of the drafters that 9 times out of 10, or perhaps 999 out of 1000, no diligent searcher needs this information." 4 James J. White & Robert S. Summers, Uniform Commercial Code 114 (4th ed. Supp. 2000). Therefore, from the perspective of providing notice, *E-B Grain Co.* is virtually indistinguishable from the case at bar.

We think the recent changes in North Carolina's version of UCC Article 9 provide additional support for Bonds' position. The new statute does not require an address for either the debtor or the secured party as a condition precedent to the sufficiency of the financing

[3] It is worth noting that counsel for the Trustee admitted at oral argument that if he were advising a client and discovered Bonds' name on the financing statement without an address, he would attempt to find it. As part of this investigation, counsel conceded that he would look to the County filing. This relatively painless inquiry would have turned up Bonds' address.

statement. While the filing office may reject a statement that does not provide an address, if the office accepts the financing statement, it is, nonetheless, effective. To reiterate, under current law, if Bonds tendered a financing statement containing no address and the filing office, as in this case, accepted it for filing, the security interest would be perfected.

Comment Five to section 25-9-516 of the General Statutes of North Carolina explains the need for an address on a financing statement. It states that the function of the address requirement "is not to identify the secured party of record but rather to provide an address to which others can send required notifications, e.g., of a purchase-money security interest in inventory or of the disposition of collateral." This comment reveals that the major purpose of the address requirement is not to protect the interests of those who are dealing with the debtor, like, for instance, the Trustee here, but, rather, to facilitate the secured party's receipt of notice of third-party actions adversely affecting the collateral. In other words, the address requirement is designed to protect secured creditors like Bonds.

Another North Carolina case that may be instructive on the issues in this litigation is *Provident Finance Co. v. Beneficial Finance Co.,* 245 S.E.2d 510 (N.C. Ct. App. 1978). In *Provident,* a husband was listed as the debtor on a filed financing statement, but the financing statement was signed by the debtor's wife. The court held that the financing statement was ineffective because the debtor did not sign the statement as required by section 25-9-402. The Trustee argues that *Provident* demonstrates that North Carolina courts would take a strict view of the requirements outlined in the filing statute. The debtor in

Provident argued that the wife who signed the statement was acting as the husband's agent. In rejecting that argument, the court reasoned that "because financing statements only perform a notice function, we believe that any agency status should be obvious on the face of the financing statement. In this case, there is no indication of any agency relationship between [the wife] and [the husband]." *Id.* at 515. Here, on the other hand, there is no confusion regarding the identity of the secured creditor, and any researcher would be certain that Bonds alone was the secured person. In fact, *Provident* reenforces the theory that North Carolina courts view notice as the sine qua non of financing statements. Bonds' financing statement provides adequate notice to a researcher that he is a secured creditor.

Furthermore, a recent bankruptcy court case in this circuit supports the theory that non-misleading mistakes on the financing statement should not nullify a security interest when general notice is otherwise provided. *In re Lea Lumber & Plywood L.L.C.* involved an adversary proceeding wherein the trustee claimed that a debtor did not "sign" the UCC-1 financing statement because the name of the corporate debtor's agent was absent and the signature that did appear was not accompanied by any indication that the signature was affixed in the capacity of an officer of the debtor's designated manager. The bankruptcy court, affirmed by the district court, rejected this argument, reasoning, in part, that "[t]he financing statement places full and accurate notice of [the creditor's] security interest on the public record, thereby serving its intended purpose under the Uniform Commercial Code." 266 B.R. 342, 439 (Bankr. E.D.N.C. 2001), *aff'd by Callaway v. Hudson Untied* [sic] *Bank, N.A.*, No. 5:01-CV-386-B0(3) (W.D.N.C. Mar. 29, 2002). In addition, the court

concluded that because the financing statement simply serves a notice function to the universe of creditors and potential creditors, "[t]his commercial reality tips the scales against using technical mistakes to undercut the secured creditor's position." *Id.* We find this reasoning sound and apply it to the purported "mistake" at issue here.

III.

In sum, we think that if the North Carolina courts were faced with the issue in this case, they would reaffirm their view that UCC financing statements exist to provide notice that a secured creditor exists. Viewing Bonds' financing statement as a whole it is apparent to us that it placed the world on notice that he was a secured creditor of BDI, and the absence of his address was a minor error that was not seriously misleading to any reasonably diligent researcher. "Invalidating [appellant's] security interest would create a windfall for the general creditors solely because of this slight dereliction. This would be an unjust result. The failure to include the addresses would, at most, have inconvenienced a creditor." *In re French,* 317 F. Supp. 1226, 1228 (E.D. Tenn. 1970) (finding a financing statement valid where the addresses for both the debtor and the secured party were omitted).

We must reverse the judgment of the district court and remand for proceedings consistent with this opinion. Accordingly, this case is

REVERSED AND REMANDED.

JUDGMENT

UNITED STATES COURT OF APPEALS

for the

Fourth Circuit

No. 01-2025
BK-97-52130C-7W
CA-01-80-1

(FILED: July 15, 2002)

In Re: BONDS DISTRIBUTING COMPANY, INCORPORATED

Debtor

BRUCE MAGERS, Trustee for Bonds Distributing Company, Incorporated;

Plaintiff-Appellee

and

WILLIAM L. MILLS, III, d/b/a The Mills Law Firm

Third Party Defendant-Appellee

v.

BONDS, INCORPORATED;

Defendant-Appellant

and

DONALD R. BONDS

Defendant & Third Party Plaintiff-Appellant

No. 01-2503
CA-01-80-1
BK-97-52130C-7W

In Re: BONDS DISTRIBUTING COMPANY, INCORPORATED

Debtor

WILLIAM L. MILLS, III, d/b/a The Mills Law Firm

Third Party Defendant-Appellant

and

BRUCE MAGERS, Trustee for Bonds Distributing Company, Incorporated

Plaintiff

v.

BONDS, INCORPORATED;

Defendant-Appellee

and

DONALD R. BONDS

Defendant & Third Party Plaintiff-Appellee

Appeal from the United States District Court for the Middle District of North Carolina at Durham

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In accordance with the written opinion of this Court filed this day, the Court reverses the judgment of the District Court. This case is remanded to the District Court

for further proceedings consistent with the Court's opinion.

/s/ Patricia S. Connor
CLERK

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA

BRUCE MAGERS, Trustee in Bankruptcy for Bonds Distributing Company, Inc., Plaintiff, v. DONALD R. BONDS and BONDS, INC., Defendants. and DONALD R. BONDS, Third-Party Plaintiff, v. WILLIAM L. MILLS, III, Attorney at Law d/b/a THE MILLS LAW FIRM, Third-Party Defendant.	) CIVIL NO. 1:01CV00080

JUDGMENT
(Filed Jul. 31, 2001)

BULLOCK, District Judge

This civil action came on for trial before the court and a jury during the session of court beginning July 16, 2001. At the close of all the evidence the court granted the Trustee Bruce Mager's motion for a judgment as a matter of law on the Trustee's preference claim of $122,186.24 against Defendants Donald R. Bonds and Bonds, Inc. The remaining issues were duly tried and answered by the jury as follows:

1. What was the value of Bonds Distributing Company, Inc.'s assets on August 21, 1997?

$1,400,000
(Amount)

2. Did Mr. Mills have a duty to Mr. Bonds to advise him of the possible consequences of remaining a director of Bonds Distributing Company, Inc.?

Yes
(Yes or No)

3. If yes, did Mr. Mills breach that duty?

Yes
(Yes or No)

4. If yes, was Mr. Mills' breach of duty a proximate cause of Mr. Bonds' damage?

Yes
(Yes or No)

5. Did Mr. Bonds' own negligence contribute to his damages resulting from his remaining a director of Bonds Distributing Company, Inc.?

Yes
(Yes or No)

6. Did Mr. Mills have a duty to Mr. Bonds to ensure that Mr. Bonds' address was on the UCC financing statement filed with the Secretary of State?

Yes
(Yes or No)

7. If yes, did Mr. Mills breach that duty?

Yes
(Yes or No)

8. If yes, was Mr. Mills' breach of duty a proximate cause of Mr. Bonds' damage?

Yes
(Yes or No)

9. Did Mr. Bonds' own negligence contribute to his damages resulting from the filing of the incomplete UCC financing statement with the Secretary of State?

No
(Yes or No)

NOW, THEREFORE, IT IS ORDERED AND ADJUDGED that Bruce Magers, Trustee in Bankruptcy for Bonds Distributing Company, Inc., Plaintiff, shall recover from Donald R. Bonds and Bonds, Inc., Defendants, the sum of ONE HUNDRED TWENTY-TWO THOUSAND ONE HUNDRED EIGHTY-SIX AND 24/100's DOLLARS ($122,186.24) and the sum of ONE MILLION FOUR HUNDRED THOUSAND AND NO/100's DOLLARS ($1,400,000.00), with pre-judgment interest on each sum computed at the rate provided by federal law from August 14, 1998.

IT IS FURTHER ORDERED AND ADJUDGED that upon the payment of Defendant Donald R. Bonds of the sum of $1,400,000.00 plus interest at the federal rate from August 14, 1998, to Bruce Magers, Trustee in Bankruptcy for Bonds Distributing Company, Inc., Donald R. Barnes [sic] shall have and recover by reason of indemnity an identical amount from William L. Mills, III, d/b/a "The Mills Law Firm."

IT IS FURTHER ORDERED that each party shall bear their own costs.

/s/ Frank W. Bullock, Jr.
United States District Judge

July 31, 2001

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA

IN RE:	)
BONDS DISTRIBUTING COMPANY, INC.,	) 97-52130-7W) 98-6044W
Debtor.	)
BRUCE MAGERS, Trustee in Bankruptcy for Bonds Distributing Company, Inc.,	)
Plaintiff,	)
v.	) CIVIL NO. 1:01CV00080
DONALD R. BONDS and BONDS, INC.,	)
Defendants.	)
and	)
DONALD R. BONDS,	)
Third-Party Plaintiff,	)
v.	)
WILLIAM L. MILLS, III, Attorney at Law d/b/a THE MILLS LAW FIRM,	)
Third-Party Defendant.	)

ORDER
(Filed Jun 1, 2001)

BULLOCK, District Judge

This case is before the court on appeals by Defendants Donald R. Bonds and Bonds, Inc., and Third-Party Defendant William L. Mills, III, Attorney at Law d/b/a The Mills Law Firm, from an order entered on April 3, 2000, by the

United States Bankruptcy Court upon motions for summary judgment filed in that court by Plaintiff Bruce Magers, Trustee in Bankruptcy for Bonds Distributing Company, Inc., Defendants Donald R. Bonds and Bonds, Inc., and Third-Party Defendant William L. Mills, III. Plaintiff's motion for summary judgment was denied except with respect to the second claim for relief which was granted. In ruling in Plaintiff's favor on that claim, the bankruptcy court found that Defendant Bonds did not perfect a security interest in the assets of Bonds Distributing Company, Inc., and as a result Plaintiff is entitled to avoid the transfer of the assets of Bonds Distributing Company, Inc., and to recover from Defendant Bonds the value of such assets as of August 21, 1997. Both Defendants' motion for summary judgment and Third-Party Defendant's motion for summary judgment were denied.

The court has considered the legal issues raised by the parties in their briefs and in the arguments of counsel heard on May 24, 2001. The court **AFFIRMS** in all respects the order of the bankruptcy court for the reasons set out in the thorough and well-reasoned opinion of that court.

/s/ Frank W. Bullock, Jr.
United States District Judge

June 1, 2001

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
WINSTON-SALEM DIVISION

IN RE:	)	
Bonds Distributing Company, Inc.	)	Case No. 97-52130C-7W
Debtor.	)	
Bruce Magers, Trustee in Bankruptcy for Bonds Distributing Company, Inc.,	)	
Plaintiff,	)	Adversary No. 98-6044
v.	)	
Donald R. Bonds and Bonds, Inc.,	)	
Defendants.	)	
Donald R. Bonds,	)	
Third-Party Plaintiff,	)	
v.	)	
William L. Mills, III, Attorney at Law, d/b/a/ "The Mills Law Firm",	)	
Third-Party Defendant.	)	

MEMORANDUM OPINION

This adversary proceeding came before the court on October 5, 1999, for hearing upon motions for summary judgment filed on behalf of the plaintiff, the defendants and the third-party defendant. Thomas W. Waldrep, Jr., and Daniel C. Bruton appeared on behalf of the plaintiff, Richard S. Gordon appeared on behalf of the defendants

and G. Gray Wilson appeared on behalf of the third-party defendant.

BACKGROUND

Bonds Distributing Company, Inc. ("the Debtor") was incorporated under the laws of the State of North Carolina in 1976. From the date of incorporation through November 7, 1995, Donald R. Bonds ("Bonds") was the president, sole director and sole shareholder of the Debtor. The primary business of the Debtor involved the operation of a wholesale outlet for small engine parts for outdoor power equipment such as chain saws, lawnmowers, edgers, etc. Up until November of 1995, Bonds managed the business operations of the Debtor.

In the summer of 1995, Bonds had discussions with Stephen H. Young ("Young") concerning the sale of the Debtor to Young. On November 7, 1995, Bonds, Young and the Debtor entered into a stock purchase agreement evidencing their agreement to a transaction in which, among other things, 4,000 shares of Bonds' stock in the Debtor were sold to Young for the purchase price of $161,121.10; approximately 90% of Bonds' shares of stock in the Debtor (35,999 shares) were redeemed by the Debtor in exchange for a $1,451,000.00 promissory note payable to Bonds; the Debtor granted to Bonds a security interest in all of the assets of the Debtor to secure the payment of the promissory note; Young granted to Bonds a security interest in the 4,000 shares which he acquired from Bonds; and Bonds retained one share of stock in the Debtor and continued as a director of the Debtor.

Following the closing of the transaction, Young became president of the Debtor, assumed control of the

Debtor and managed the business operations of the Debtor. In approximately July of 1997, the Debtor defaulted on its payments to Bonds under the $1,451,000.00 promissory note. Bonds initiated collection efforts against the Debtor, which included a foreclosure sale which was held on August 21, 1997, at the Cabarrus County Courthouse. The foreclosure sale was conducted by one of the attorneys who represented Bonds. The only bid was one made by the attorney in the amount of $1,484,391.11

Following the foreclosure sale, Bonds, Inc., a new corporation formed by Bonds shortly before the sale, assumed control of Debtor's assets, including the inventory which Debtor owned at the time of the foreclosure sale. Bonds, Inc., under the management of Bonds, thereafter conducted a business similar to that which had been conducted by the Debtor prior to the foreclosure sale.

On October 30, 1997, approximately two months after the foreclosure sale, an involuntary petition under Chapter 7 of the Bankruptcy Code was filed against the Debtor. An order for relief under Chapter 7 of the Bankruptcy Code was entered in the bankruptcy court on December 16, 1997, and Bruce Magers (the "Trustee") was named as Trustee in the case.

On August 14, 1998, the Trustee filed the adversary proceeding which is now before the court asserting that Bonds never acquired a perfected security interest in the Debtor's assets and attacking the validity of the foreclosure sale conducted by Bonds in August of 1997. Bonds and Bonds, Inc., answered, denying any liability to the Trustee and raising various affirmative defenses. Additionally, Bonds asserted a professional malpractice claim

against the third-party defendant alleging that the third-party defendant acted as his attorney with regard to the transaction with Young and was negligent with respect to the legal representation provided to Bonds.

MOTIONS FOR SUMMARY JUDGMENT

In his motion for partial summary judgment the Trustee seeks summary judgment as to the Second, Third, Seventh, Ninth and Tenth claims for relief. In their motion for summary judgment the defendants seek summary judgment as to all of the claims asserted by the Trustee. In his motion for summary judgment the third-party defendant seeks summary judgment as to the professional malpractice claim asserted by Bonds as third-party plaintiff.

DISCUSSION

A. Summary Judgment Standard.

Under Rule 56 of the Federal Rules of Civil Procedure, which is incorporated into Rule 7056 of the Federal Rules of Bankruptcy Procedure, summary judgment is proper when there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. "Where the moving party has carried its burden of showing that the pleadings, depositions, answers to interrogatories, admissions and affidavits in the record construed favorably to the nonmoving party, do not raise a genuine issue of material fact for trial, entry of summary judgment is appropriate." *Gutierrez v. Lynch,* 826 F.2d 1534, 1536 (6th Cir. 1987) (citing *Celotex Corp. v. Catrett,* 477 U.S. 317, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986)); *In re Specialty Concepts, Inc.,* 108 B.R. 104 (W.D.N.C. 1989);

In re Caucus Distribs., Inc., 83 B.R. 921 (Bankr. E.D. Va. 1988).

In order to carry this burden, a plaintiff who is moving for summary judgment must show through affidavits, depositions or admissions all facts required to support each element of the claim and that none of those facts are disputed. *See Moore's Federal Practice,* § 56.13. p. 56-134 (3d ed.1998) (movant must make a prima facie case for summary judgment by establishing (1) the apparent absence of any genuine dispute of material fact and (2) movant's entitlement to judgment as a matter of law on the basis of the undisputed facts). In determining whether the evidence is sufficient to establish the claim, the court must apply the substantive evidentiary standard that would be applicable at trial. *See Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 248, 106 S.Ct. 2505, 2510, 91 L.Ed.2d 202 (1968).

The evidence must be viewed in the light most favorable to the nonmoving party, and inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. *See In re Graham,* 94 B.R. 386 (Bankr. E.D. Pa.1988); *In re Trauger,* 101 B.R. 378 (Bankr. S.D. Fla. 1989). However, the existence of a factual dispute is material and precludes summary judgment only if the disputed fact is determinative of the outcome under applicable law. *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 248, 106 S.Ct. 2505, 2510, 91 L.Ed.2d 202 (1986). The party seeking summary judgment bears the initial responsibility of informing the court of the basis of its motion, and also must identify those portions of the record that it believes demonstrates the absence of a genuine issue of material fact. Only after the movant has sustained the initial burden of production does the burden

shift to the nonmovant to show the court that there is a genuine issue for trial. However, once this is done, the opposing party must set forth the specific facts showing there is a genuine issue for trial. Only when the entire record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, can the court find there is no genuine issue for trial. *See In re Trauger,* 101 B.R. at 380, citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 587, 106 S.Ct. 1348, 2513, 89 L.Ed.2d 538 (1986).

B. Application of Standard to Claims.

Since at least one of the parties has moved for summary judgment as to each of the claims alleged by the parties, the court will discuss each of the claims in chronological order, resolving whether either of the parties is entitled to summary judgment with respect to each claim.

1. First Claim – Plaintiff's Preference Claim.

In the First Claim, the Trustee seeks the recovery of $122,168.24 in transfers paid by the Debtor to Bonds during the year immediately preceding the bankruptcy filing, which the Trustee maintains are preferential under § 547 of the Bankruptcy Code. While the general "look-back" period under § 547 is 90 days, § 547(b)(4)(B) allows the recovery of preferential payments made within one year of the petition date when the transferee is an "insider." The defendants contend that they are entitled to summary judgment on the Trustee's preference claim because Bonds was not an insider when the payments were made. Because the Trustee has produced evidence showing that Bonds was a director of the Debtor during

the one-year period, the court concludes that Bonds was an insider under § 547 and therefore is not entitled to summary judgment as to the preference claim.

Section 101(31) of the Bankruptcy Code defines an "insider" as follows:

> (B) if the debtor is a corporation –
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> (i) director of the debtor;
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> (ii) officer of the debtor;
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> (iii) person in control of the debtor;
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> (iv) partnership in which the debtor is a general partner;
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> (v) general partner of the debtor; or
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> (vi) relative of a general partner, director, officer, or person in control of the debtor;

While acknowledging that Bonds was a director of the Debtor at the time of the transfers, the defendants argue that since Bonds did not "act" like a director, the plain language of § 101(31)(B) should not apply in this case. None of the cases cited by the defendants support the conclusion that this court should interpret the meaning of "insider" as not including a director of a corporate debtor.

The defendants quote the following language from the Fourth Circuit opinion of *In re Broumas,* 1998 WL 77842, at *7 (4th Cir. 1998):

> an insider may be any person or entity whose relationship with the debtor is sufficiently close so as to subject the relationship to careful scrutiny. . . . Accordingly, insider status is determined

> by a factual inquiry into the debtor's relationship with the alleged insider.

Defendant's Memorandum, pp. 16-17. What the defendants have overlooked is that immediately preceding this passage, the *Broumas* court quoted the applicable portion of § 101(31) and stated that the list of insiders in that section is "non-exhaustive." *Id.* Accordingly, the court wrote the above-quoted passage in order to convey that, in addition to the list of insiders found in § 101(31), courts can *also* look to the facts and circumstances of a case to determine if someone who does not meet the criteria of § 101(31) is nonetheless an "insider." Additionally, in *Broumas* the debtor was an individual, not a corporation. There is no discussion whatever in *Broumas* as to whether a director of a corporation should or should not be considered an insider as is suggested by the defendants.

The defendants also cite *In re Babcock Dairy Co. of Ohio, Inc.*, 70 B.R. 657 (Bankr. N.D. Ohio 1986), in support of their contention that, although a director, Bonds was not an "insider." Like *Broumas, Babcock Dairy* is inapposite to the facts of this case. Although *Babcock Dairy* does involve a debtor corporation, the court specifically found that the defendant was not a director of the debtor corporation at the time that the preferential transfers were paid. *See id.* at 661. Accordingly, the court shifted its focus from § 101(25)(B)(i)[9] of the Code – where the Code defines an insider as a director – to § 101(25)(B)(iii)[10] – where the

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[9] Currently § 101(31)(B)(i).

[10] Currently § 101(31)(B)(iii).

Code defines an insider as a "person in control of the debtor."

Thus, the quoted language in the Defendants' Memorandum[11] has no bearing on whether a director is an insider under § 101(31)(B)(i), but, instead, addresses whether a non-director can be "a person in control of the debtor" under § 101(31)(B)(iii). Therefore, as in *Broumas,* there is no discussion in *Babcock Dairy* concerning whether a person who is a director of a debtor corporation ought not to be considered an insider of the corporation despite the plain language of § 101(31)(B)(i). Rather, the *Babcock Dairy* court specifically recognized that "any person that is a director of a corporate debtor . . . is automatically considered to be an insider." *Id.* at 660.

Also cited by the defendants is *In re Boston Publishing Co.,* 209 B.R. 157 (Bankr. D. Mass. 1997). Like *Babcock Dairy, Boston Publishing* involves a defendant who was a former director of a debtor corporation. Accordingly the court did not look to § 101(31)(B)(i) in examining the defendant's insider status. Rather, the court focused on the

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[11] The following language from *Babcock Dairy* is quoted in the Defendants' Memorandum:

> "It does not appear that a standard has been established for determining the degree to which a person must control a debtor before he is considered to be an insider. However, it does appear that . . . the person must exercise sufficient authority over the debtor so as to unqualifiedly dictate corporate policy and the disposition of corporate assets. . . . It is insufficient that the alleged insider had only a superior bargaining position in a contractual relationship with the Debtor.

Babcock Dairy, 70 B.R. at 661."

point that the list set forth in § 101(31)(B) is not exclusive, and that an insider may be any person whose relationship with the debtor is sufficiently close so as to subject the relationship to careful scrutiny. *See id.* at 169.

"The plain meaning of legislation should be conclusive, except in 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.'" *Ford Motor Credit Co. v. Dobbins,* 35 F.3d 860, 868 (4th Cir. 1994) (quoting *United States v. Ron Pair Enters., Inc.,* 489 U.S. 235, 242, 109 S.Ct. 1031, 103 L.Ed.2d 290 (1989). When interpreting statutes, a court should "look first to the plain language of a statute and interpret it by its ordinary, common sense meaning. . . . If the statutory terms are unambiguous, our review generally ends and the statute is construed according to the plain meaning of its words.'" *Elliott Assocs., L.P. v. Banco De La Nacion,* 194 F.3d 363, 371 (2d Cir. 1999) (citations omitted). *In accord In re Fegeley,* 118 F.3d 979, 983 (3d Cir. 1997); *In re JKJ Chevrolet, Inc.,* 26 F.3d 481, 483 (4th Cir. 1994). The definition of "insider" contained in § 101(31) of the Bankruptcy Code clearly and unambiguously includes a director of a corporate debtor. Giving this statutory provision its plain meaning does not produce a result demonstrably at odds with the intentions of Congress in adopting this provision. Pursuant to the foregoing tenets of statutory interpretation, Bonds, as a director of the Debtor, must be regarded as an insider.

2-3. Second and Third Claims – Failure to Perfect Security Interest.

In these claims the Trustee alleges that no security interest was perfected because of the inadequacy of the description of collateral and because the financing

statement filed with the Secretary of State contains no address for Bonds. The court first will address issue of whether the financing statements contain an adequate description of the collateral, including whether the description of collateral includes after-acquired property.

(a) Description of Collateral.

The requirement that there be a description of the collateral applies to both the security agreement and the financing statements. Under G.S. § 25-9-203, one of the requirements for a security interest to attach is that the debtor have signed "a security agreement which contains a description of the collateral." Under G.S. § 25-9-402(1), one of the formal requisites of a financing statement is that it contain "a statement indicating the types, or describing the items, of collateral."

The present case does not involve a complete omission of any description of collateral, since both the security agreement and the financing statements purport to describe collateral. The stock purchase agreement provides for the issuance of a promissory note evidencing the amount to be paid for the redemption of 39,999 shares of stock owned by Bonds. The agreement provides that the note is to be secured "by a Security Agreement and Financing Statement executed by Corporation covering the assets identified in subparagraph (a) through (f) above." The assets which are described in these subparagraphs are the Debtor's inventory, all "hard or 'fixed' assets", all motor vehicles and all accounts receivable and cash balances in the corporate bank accounts at the close of business on October 31, 1995. Although these subparagraphs state that the assets are to be identified on written schedules or

exhibits, no such schedules or exhibits are attached to the stock purchase agreement.

The parties signed a security agreement on the same date as the stock purchase agreement. In the security agreement, the collateral is described as follows:

> [A]ll of the personal property, including, but not limited to, the assets identified in Paragraph 2 of the Stock Purchase Agreement dated November 7, 1995, and the various Schedules referenced therein which shall be attached hereto as well as all additional equipment, furniture and fixtures, supplies, inventory, instruments, accounts receivable, wherever located and including, substitutions, additions, replacements, proceeds, and proceeds of proceeds, of any nature and kind, used and unused by the Debtor in the business.

No schedules or exhibits are attached to the security agreement.

Financing statements also were signed on the date of the closing, which subsequently were recorded in the Office of the Register of Deeds of Cabarrus County and in the Office of the North Carolina Secretary of State. The description of the collateral contained in the financing statements reads as follows:

> All of the personal property, including, but not limited to the assets identified in paragraph 2 of the Stock Purchase Agreement dated November 7, 1995, and as shown on the schedules attached to that agreement, which schedules which [sic] shall be attached hereto; as well as all additional equipment, furniture, fixtures, supplies, inventory, instruments, accounts receivable, where

> ever located and including substitutions, additions, accounts receivables, replacements, proceeds, and proceeds of proceeds of any kind or nature, used and unused by Debtor."

Although this description refers to "schedules which shall be attached hereto", no schedules were attached to either of the financing statements as recorded.

The issue thus presented is whether the foregoing descriptions of collateral are sufficient to satisfy the requirements of G.S. §§ 25-9-203 and 25-9-402(1). In arguing that the description is insufficient, the Trustee points out that the description contains three clauses consisting of (1) the reference to "all personal property"; (2) the reference to attached schedules; and (3) the reference to all other equipment, furniture and fixtures, etc. The Trustee argues that neither of these clauses constitutes a sufficient description and that the financing statements therefore do not contain a sufficient description of the collateral. This argument is not accepted because the description in the financing statements must be read as a whole, rather than being dissected into separate parts, with each part then being read as if the other parts did not exist. When the description is read as a whole, and each portion thereof is given effect, the description is sufficient to identify the collateral as being all of the equipment, furniture, fixtures, supplies, inventory, instruments and accounts receivable of Bonds Distributing Company, Inc.

If the description referred only to "all personal property" there are cases which would support a finding of

insufficiency.[12] The same would be true if the description consisted only of a reference to an unattached schedule which was not a part of the public record.[13] However, the description in the present case is not so limited. It begins by referring to "all" of the personal property of the Debtor "including" the assets shown in the schedules, as well as "all additional" equipment, furniture, fixtures, supplies, inventory, instruments and accounts receivable. Even without knowing what equipment, furniture, fixtures, supplies, inventory, instruments and accounts receivable are listed on the schedules, it is apparent from this description, read as a whole, that it encompasses *all* of Debtor's equipment, furniture, fixtures, supplies, inventory, instruments and accounts receivable.

The applicable test of the sufficiency of a description of collateral is contained in G.S. § 25-9-110.[14] Under this provision, a description is sufficient if it "reasonably identifies" what is described. As reflected in the Amended Official Comment, the only requirement under G.S. § 25-9-110 is that "the description do the job assigned to it – that it make possible the identification of the thing described." The description in the present case makes it possible to identify all of Debtor's equipment, furniture, fixtures,

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[12] *See In re Ashkenazy Enters., Inc.*, 94 B.R. 645, 647 (Bankr. C.D. Calif. 1986). *Compare Womack v. Newman Fixture Co.*, 11 UCC Rep. Serv.2d 285 (Ark. App. 1989); *In re John Oliver Co.*, 91 B.R. 643 (Bankr. D.N.H. 1988).

[13] *See In re H.L. Bennett Co.*, 588 F.2d 389, 391 (3rd Cir. 1978); *In re Waldick Aero-Space Devices, Inc.*, 49 B.R. 192 (Bankr. D.N.J. 1985).

[14] G.S. § 25-9-110 provides: "For the purposes of this article any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described."

supplies, inventory, instruments and accounts receivable as being the collateral described in the financing statement. The description therefore "reasonably identifies" those assets as collateral covered by the security interest granted to Bonds and thereby satisfies the requirements of G.S. § 25-9-402 that the financing include a description of the collateral. Accordingly, the Trustee is not entitled to avoid the security interest asserted by Bonds on the ground that the description of collateral is insufficient.

(b) After-Acquired Property.

G.S. § 25-9-204 permits a creditor to obtain a security interest in property which is acquired by the debtor after the execution of the security agreement. The statutory language making this possible provides that "a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral." The effect of this language is explained in the Amended Official Comment as follows: "Subsection 1 makes clear that a security interest arising by virtue of an after-acquired property clause has equal status with a security interest in collateral in which the debtor has rights at the time value is given under the security agreement."

The requirement under G.S. § 25-9-204 is that the security agreement contain the language which provides that the collateral includes after-acquired property. The Amended Official Comment points out that this "should not be confused with the use of financing statements in notice filing." Since the reference to after-acquired property clauses in G.S. § 25-9-204 is limited to the security agreement, "[t]here is no need to refer to after-acquired

property or future advances in the financing statement." Therefore, in the present case, whether Bonds acquired a security interest in after-acquired property depends upon the language contained in the security agreement. *See Dowell v. D.R. Kincaid Chair Co.,* 125 N.C. App. 557, 561, 481 S.E.2d 670, 673 (1997) ("it is the security agreement, and not the financing statement, which defines the extent of the security interest involved").

The fact that the security agreement in the present case does not use the exact term "after-acquired property" does not mean that no security interest was granted with respect to after-acquired property. There are no magic words which must be used in order to obtain a security interest in after-required property. All that is required under G.S. § 25-9-204 is that the security agreement contain language reflecting an intention to create a security interest in after-acquired collateral. *See In re Carter,* 203 B.R. 697, 704 (Bankr. W.D. Mo. 1996); *Central Production Credit Assn. v. Hopkins,* 810 S.W.2d 108, 111 (Mo. Ct. App. 1991); *Kubota Tractor Corp. v. Citizens & Southern Nat'l Bank,* 403 S.E.2d 218, 222 (Ga. Ct. App. 1991).

In the present case, the description of collateral in the security agreement involves incorporation by reference of a description of property contained in the stock purchase agreement, as well as a separate description of collateral contained in the security agreement:

> The collateral of this Security Agreement is all of the personal property, including, but not limited to, the assets identified in Paragraph 2 of the Stock Purchase Agreement dated November 7, 1995, and the various schedules referenced therein which shall be attached hereto as well as all additional equipment, furniture and fixtures,

> supplies, inventory, instruments, accounts receivable, wherever located and including, *substitutions, additions, replacements,* proceeds, and proceeds of proceeds, of any nature and kind, used and unused by Debtor in the business. (Emphasis supplied).

In arguing that the reference to substitutions, additions and replacements should be read narrowly, the Trustee relies upon the presence of a semi-colon which appears in the description of collateral contained in the financing statements. However, the controlling description is the one contained in the security agreement, which does not contain the offending semi-colon. The use of the words "substitutions", "additions" and "replacements" is sufficient to encompass and include in the description property acquired after the execution of the security agreement. Although the description certainly is not a model of legal draftsmanship, the placement of these words is such that they logically and reasonably may be read as applying to all of the types of property referred to earlier in the description. Therefore, the court concludes that the collateral encompassed by the security agreement included all equipment, furniture and fixtures, supplies, inventory, instruments and accounts receivable owned when the agreement was executed *and* all after-acquired substitutions, additions and replacements for such property.

Even without the reference to substitutions, additions and replacements, the description in the security agreement is sufficient to encompass after-acquired accounts and inventory. As noted above, the described collateral

includes all inventory and all accounts receivable of the Debtor.[15] Because of the particular characteristics of accounts receivable and inventory and the fact that they are cyclical and constantly turning over, a majority of courts have concluded that a security agreement referring to all inventory and all accounts receivable creates a security interest in after-acquired inventory and accounts.[16] Recognizing that accounts and inventory change or turnover constantly in the ordinary course of business without affecting the identity of the res itself, these cases treat accounts and inventory as a "floating mass" which must be viewed as a single entity continuously in existence and not consisting of individual components.

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[15] Paragraph 2(a) of the stock purchase agreement refers to "inventory", while paragraph 2(d) refers to "all accounts receivable." In addition to the incorporation of these provisions, the security agreement also refers to "all additional" inventory and accounts receivable.

[16] *See, e.g., Paulman v. Gateway Venture Partners III (In re Filtercorp, Inc.),* 163 F.3d 570, 579 (9th Cir. 1998); *American Employers Ins. Co. v. American Sec. Bank, N.A.,* 747 F.2d 1493, 1500 (D.C. Cir. 1984); *National Bank v. West Tex. Wholesale Supply Co. (In re McBee),* 714 F.2d 1316, 1330-31 (5th Cir. 1983); *Manchester Nat'l Bank v. Roche,* 186 F.2d 827, 831 (1st Cir. 1951) (old UCC); *In re Fibre Glass Boat Corp.,* 324 F.Supp. 1054, 1056 (S.D. Fla. 1971); *Rosenberg v. Rudnick,* 262 F.Supp. 635, 639 (D. Mass. 1967); *In re Shenandoah Warehouse Co.,* 202 B.R. 871, 873 (Bankr. W.D. Va. 1996); *Provident Hosp. & Training Ass'n v. GMAC Mortgage Corp. (In re Provident Hosp. & Training Ass'n),* 79 B.R. 374, 380 (Bankr. N.D. Ill. 1987); *Juemmerle v. United N.M. Bank at Roswell, N.A.,* 831 P.2d 976, 979-80 (N.M. 1992); *Frankel v. Associates Fin. Servs. Co.,* 377 A.2d 1166, 1168 (Md. Ct. App. 1977). *But see In re Middle Atl. Stud Welding Co.,* 503 F.2d 1133, 1136 (3d Cir. 1974); *Covey v. First Nat'l Bank (In re Balcain Equip. Co.),* 80 B.R. 461, 462 (Bankr. C.D. Ill. 1987); *In re Taylored Prods., Inc.,* 5 U.C.C. Rep. Serv. (CBC) 286, 289-91 (Bankr. W.D. Mich. 1968).

Whether a security agreement creates a security interest in particular assets is a question which is determined by controlling state law,[17] which in the present case is North Carolina law. The North Carolina courts apparently have not decided the issue of whether a reference in a security agreement to all inventory and all accounts receivable encompasses accounts receivable and inventory acquired after the execution of the security agreement. In the absence of controlling state law on this issue, the function of this court is to predict or anticipate how the Supreme Court of North Carolina would decide the issue. *See McNair v. Lend Lease Trucks, Inc.*, 93 F.3d 325, 328 (4th Cir. 1996), *In re Bower*, 234 B.R. 109, 111 (Bankr. D. Nev. 1999); *In re Johnson*, 120 B.R. 461, 474-75 (Bankr. N.D. Ind. 1990). Having concluded that the North Carolina Supreme Court likely would adopt the rule followed by the cases cited earlier, this court concludes that the reference to all inventory and all accounts receivable encompasses accounts receivable and inventory acquired by the Debtor subsequent to the execution of the security agreement.

(c) Failure to include Secured Party's Address in Financing Statement.

It is undisputed that the financing statement filed with the Secretary of State contains no address for Bonds, who is identified in the financing statement as the secured party. The issue presented is whether this omission is fatal

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[17] *See Butner v. United States*, 440 U.S. 48, 55, 99 S.Ct. 914, 918, 59 L.Ed.2d 136 (1978); *In re Carter*, 203 B.R. 697, 703 (Bankr. W.D. Mo. 1996); *In re Shenandoah Warehouse Co.*, 202 B.R. 871, 873 (Bankr. W.D. Va. 1996).

to the perfection of a security interest by Bonds. This is a legal issue which is appropriate for determination by summary judgment.

G.S. § 25-9-302(1) requires that a financing statement be filed in order to perfect a security interest in inventory, equipment and accounts. The formal requisites for a financing statement are contained in G.S. § 25-9-402(1). Under this statute, a financing statement is sufficient if it "gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral." As stated in the Amended Official Comment to G.S. § 25-9-402, "[s]ubsection (1) sets out the simple formal requisites of a financing statement under this Article. These requirements are (1) signature of debtor; (2) addresses of both parties; (3) a description of the collateral by type of item."

In an attempt to avoid overly technical requirements, G.S. § 25-9-402(8) directs that "[a] financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading." The North Carolina Supreme Court has recognized that G.S. § 25-9-402 "adopts a system of notice filing," and that the rule of substantial compliance in subsection (8) of the statute reflects the notice function of the filing. *See Evans v. Everett,* 279 N.C. 352, 183 S.E.2d 109 (1971). *See also In re Southern Supply Co. of Greenville, N.C., Inc.,* 405 F.Supp. 20, 22 (E.D.N.C. 1975) ("One of the policies of [Article 9] is to simplify formal requisites and filing requirements and is designed to discourage the fanatical and impossibly

refined reading of statutory requirements in which courts have occasionally indulged themselves.").

As reflected in the language of G.S. § 25-9-402(1), the purpose of the address requirement for the secured party in a financing statement is to enable other creditors to contact the secured party for the purpose of obtaining information concerning the security interest. *See Mid-American Dairymen, Inc. v. Newman Grove Coop. Creamery Co.,* 214 N.W.2d 18, 23 (Neb. 1974). Some cases recognize that if a financing statement lists a partial address which is sufficient to enable creditors to locate the secured party, then the financing statement, although deficient, substantially complies with the requirement of G.S. § 25-9-402(1). For example, in *E-B Grain Co. v. Denton,* 73 N.C. App. 14, 325 S.E.2d 522 (1985), the court determined that the debtor's address, listed as "Whitakers, N.C. 27891", was not seriously misleading and satisfied the requirement of G.S. § 25-9-402(1).

However, the situation presented in the present case is different because the financing statement at issue provided no information regarding the address of the secured party. Despite the general rule of liberality found in G.S. § 25-9-402(8) and the recognition that a partial address may pass muster under the rule of substantial compliance, many courts have reached a different conclusion when there is no attempt whatsoever to comply with the address requirement of G.S. § 25-9-402(1), and the address of the secured party or the debtor is totally omitted from the financing statement. Such an omission involves substantial noncompliance with the terms of the statute and has been treated as preventing the perfection of the creditor's security interest. *See In re Keefer,* 25 B.R. 597 (Bankr. D. Idaho 1983); *In re Smith,* 205 F. Supp. 27,

28-29 (E.D. Pa. 1962) (omission of debtor's address from financing statement, as a matter of law, prevents such a statement from perfecting a security interest); *In re Permian Anchor Servs., Inc.,* 649 F.2d 763, 766 (10th Cir. 1981) ("There are no degrees of invalidity. A financing statement is invalid because of a lack of debtor's signature as it is for lack of the debtor's address."); *Whitworth v. Kreuger,* 558 P.2d 1026, 1035 (Idaho 1976) ("The address requirement is strictly construed because the potential creditor must be able to know where to go to get further information. . . . A financing statement is insufficient when it does not contain the address of the creditor."); *In re L & K Transp. Co., Inc.,* 8 B.R. 921, 922 (Bankr. D. Mass. 1981) (complete absence of debtor's address is not the type of minor error contemplated by § 402(8) unless the debtor is so well known that there could be no question as to its identity and address); *Cushman Sales and Service of Neb., Inc. v. Muirhead,* 268 N.W.2d 440, 444 (Neb. 1978) (financing statement fatally defective where address of secured creditor omitted); *Strevell-Paterson Fin. Co. v. May,* 422 P.2d 366, 369 (N.M. 1967) ("If the secured party's address does not appear it would be an undue burden on the person seeking such information to find him. The filing system will perform its intended function only if the secured party substantially complies with the requirements of § 9-402(1)."); *In re HGS Technical Assoc., Inc.,* 14 UCC Rep. Serv. 237 (Bankr.E.D. Tenn. 1972) (lack of address of debtor caused financing statement to be ineffective – "[T]he courts in the guise of interpretation should not ignore express requirements of the Code as to the content of the financing statement. Nor should the Code requirements be scuttled on a plea that they are loose and relaxed."). *Cf. In re Environmental Aspecs, Inc.,* 235 B.R. 378, 388-89 (E.D.N.C. 1999) (the court outlined the

"relationship between the notice-filing policy behind the statute's requirement that a creditor file a financing statement, and the discrete requirement that a sufficient financing statement contain certain enumerated elements," and determined that the omission of the debtor's signature from a financing statement caused the creditor's security interest to be unperfected). *But see Rooney v. Mason,* 394 F.2d 250 (10th Cir. 1968); *In re French,* 317 F. Supp. 1226 (E.D. Tenn. 1970); *Riley v. Miller,* 549 S.W.2d 314 (Ky. Ct. App. 1977).

Defendants argue that the financing statement in the present case should be upheld under G.S. § 25-9-402(8) because the financing statement substantially complied with G.S. § 25-9-402(1) and was not seriously misleading. This argument is rejected. In order for the rescue provisions of G.S. § 25-9-402(8) to be operative, the financing statement must be one which "substantially" complies with the requirements of G.S. § 25-9-402(1). As a majority of the cases have recognized, a financing statement which completely omits the address of the secured creditor does not substantially comply with that statute. By its terms, G.S. § 25-9-402(8) is applicable where there are "minor errors" which are not seriously misleading. The complete omission of the secured creditor's address from a financing statement involves a failure to comply with one of the statutory requirements under G.S. § 25-9-204(1), which may not be passed off as a minor error. Perhaps, from the standpoint of semantics, it is debatable whether the total absence of information "mis" leads; however, this is immaterial where, as in the present case, the omitted information is specifically required by the statute and its absence from the financing statement prevents the financing statement from serving one of the purposes expressly

stated in the statute, i.e., giving the location of the source from which "information concerning the security interest may be obtained." This court concludes, therefore, that the North Carolina Supreme Court would, as most other courts have, decide that although the requirements of the U.C.C. have been liberalized somewhat under § 9-402(8), the complete omission of one of the basic elements of an effective financing statement constitutes noncompliance with G.S. § 25-9-402(1), not substantial compliance, and renders a secured creditor's security interest unperfected. As recognized by the court in *In re Softalk Publishing Co.*, 64 B.R. 523, 525 (9th Cir. BAP 1986), *aff'd*, 856 F.2d 1328 (9th Cir. 1988), "[s]ince the U.C.C. has reduced the formal requisites of a financing statement to a minimum, there can be no acceptable excuse for failure to comply with its provisions." Because the financing statement filed with the Secretary of State provided no information regarding the Bonds' address, it did not comply with G.S. § 25-9-402 and was insufficient to enable Bonds to perfect a security interest in the assets of the Debtor. Accordingly, Bonds never acquired a perfected security interest in the Debtor's assets.

The fact that the financing statement recorded in Cabarrus County includes Bonds' address does not cure the defect in the financing statement filed with the Secretary of State. Under G.S. § 25-9-401(c), "in order to perfect a security interest" in the assets of a debtor with a single place of business in North Carolina, two financing statements must be recorded, one with the Secretary of State and the other in the county in which the debtor has its place of business. Courts in dual filing states do not allow defective financing statements to ride on the coattails of

proper filings. Rather, most courts require that *all* financing statements, whether filed locally or with the secretary of state, stand on their own. *See, e.g., In re B. Hollis Knight Co.,* 605 F.2d 397 (8th Cir. 1979) (filing with secretary of state was proper but local filing failed to list one of two debtors, so security interest was unperfected); *In re Multi-Photo, Inc.,* 62 B.R. 159 (Bankr. E.D. Mo. 1986) (debtor signed local filing but failed to sign filing with secretary of state, so security interest of creditor was unperfected); *In re Sportswear Shoppe, Ltd.,* 15 B.R. 970 (Bankr. W.D. Mo. 1981) (court implied that what a search of the local filing would reveal was irrelevant since the filing with the secretary of state was deficient, and therefore the security interest was unperfected); *First Nat'l Bank of St. Charles v. Chemical Prods., Inc.,* 637 S.W.2d 373 (Missouri Ct. App. 1982) (local filing was proper but central filing was defective, so court did not look to local filing under general notice policy of the Code, but instead required central filing to stand on its own). This court concludes that under the rule which would be adopted in North Carolina, the failure to file properly with the Secretary of State resulted in the non-perfection of Bonds' security interest notwithstanding the filing which was made in Cabarrus County.

Since Bonds did not have a perfected security interest in Debtor's assets, the Trustee is entitled to avoid the transfer of Debtor's assets which occurred when Bonds repossessed and sold the assets on August 21, 1997. Such transfer from an obviously insolvent debtor enabled Bonds to receive more than he would receive as an unsecured creditor in a Chapter 7 case. *See In re Colacci's of Am., Inc.,* 490 F.2d 1118, 1120 (10th Cir. 1974) (repossession of equipment within 90 days of bankruptcy constituted a

preferential transfer where repossessor did not have a perfected security interest); *Glessner v. Massey-Ferguson, Inc.*, 353 F.2d 986, 992 (9th Cir. 1966) ("It follows then that repossession by the appellee of the property subject to the conditional sale agreements, under the circumstances here and within four-months period next preceding filing the petition in bankruptcy, must be held to be a preference"). Section 550(a) provides that "[e]xcept as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b) of 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property." As reflected in this language, the successful plaintiff in an avoidance action is entitled to recover the specific property transferred or, with court approval, the value of such property from the initial transferee or the immediate or mediate transferee of the initial transferee. *See generally,* 5 *Collier on Bankruptcy* ¶ 550.02 (15th ed. 1999).

The Code provides no guidelines regarding when to permit recovery of the value of the property rather than the property itself. However, the cases recognize that one situation in which the Trustee is entitled to recover the value of the property is when the debtor's property has been disposed of by the transferee and cannot be recovered. *See In re Willaert,* 944 F.2d 463, 464-65 (8th Cir. 1991); *In re Da-Sota Elevator Company,* 939 F.2d 654, 656 (8th Cir. 1991); *In re McLaughlin,* 183 B.R. 171, 177 (Bankr. W.D. Wis. 1995); *In re Classic Drywall, Inc.,* 127 B.R. 874, 877 (D. Kan. 1991). The value of the transferred property is assessed as of the date of the transfer and, generally, the value which may be recovered is the fair market value of the property. *See In re Vann,* 26 B.R. 148

(Bankr. S.D. Ohio 1982); *In re Hudson Printing & Lithographing Co.,* 28 B.R. 876 (Bankr. E.D. Tenn. 1983); *In re Nevada Implement Co.,* 22 B.R. 105 (Bankr. W.D. Mo. 1982); *In re McLaughlin,* 183 B.R. at 177; *In re Shape, Inc.,* 176 B.R. 1, 3 (Bankr. D. Me. 1994); *In re Chambers,* 125 B.R. 778, 792 (Bankr. W.D. Mo. 1991); *In re Brown,* 118 B.R. 57, 60 (Bankr. N.D. Tex. 1990).

The record in the present case reflects that Bonds, Inc., has been selling inventory and collecting accounts receivable since August of 1997. It thus appears impractical, if not impossible, to order the recovery of the property itself. Therefore, the court concludes that the Trustee is entitled to recover the value of the property which was owned by the Debtor at the time of the foreclosure sale on August 21, 1997.

The Trustee argues that the $1,484,391.11 bid at the foreclosure sale establishes the fair market value of the property at that figure and that the Trustee therefore is entitled to a summary judgment in the amount of $1,484,391.11. This argument is not accepted. There is evidence from which it could be inferred that the bid at the foreclosure sale was intended as a credit bid based upon the amount of the indebtedness owed by the Debtor, rather than the value of the property. Also, there is evidence in the record tending to show that an inventory was done shortly after the sale which showed an aggregate value of only $863,571.88. Thus, the evidence regarding the value of the property is in dispute, and value therefore may not be determined by summary judgment. The result is that the Trustee is entitled to a summary judgment adjudging that he is entitled to recover from the defendants the value of the property that was owned by the Debtor at the time of the foreclosure sale on August 21, 1997, but the amount

of the judgment is a matter to be determined by the jury. The Trustee also is entitled to interest on any recovery at the federal rate from the date of the filing of the complaint in this adversary proceeding. *See Precision Walls, Inc. v. Crampton,* 196 B.R. 299, 305 (Bankr. E.D. N.C. 1996); *In re Shape, Inc.,* 176 B.R. 1, 3 (Bankr. D. Me. 1994).

4. Fourth Claim – Fraudulent Conveyance.

In the Fourth Claim the Trustee alleges that the issuance of the Redemption Note and the Security Agreement by the Debtor constituted a fraudulent conveyance under G.S. 39-15, et. seq., which is avoidable under § 544(b) of the Bankruptcy Code. In support of this claim the Trustee contends that issuance of the promissory note and security agreement was not supported by sufficient consideration because the Debtor received no value for the issuance of these instruments. According to the Trustee, the transfer represented by the issuance of the promissory note and security agreement occurred while the Debtor was insolvent or rendered the Debtor insolvent.

Under North Carolina law one of the "badges of fraud" which may constitute evidence of a fraudulent conveyance is a transaction in which the conveyance is voluntary and the grantor does not retain property fully sufficient and available to pay its existing debts. *See Edwards v. Northwestern Bank,* 39 N.C. App. 261, 250 S.E.2d 651 (1979); *Aman v. Walker,* 165 N.C. 224, 81 S.E. 162 (1914). There is substantial authority that such a situation may arise in the context of a leveraged buyout. *See Moody v. Security Pac. Bus. Credit, Inc.,* 971 F.2d 1056, 1064 (3d Cir. 1992); *United States v. Tabor Court Realty Corp.,* 803 F.2d 1288, 1297 (3d Cir. 1986), *cert. denied,* 483 U.S. 1005, 107 S.Ct.

3229, 97 L.Ed.2d 735 (1987); *Zahn v. Yucaipa Capital Funds,* 218 B.R. 656 (D.R.I. 1998); *In re Healthco Int'l, Inc.,* 195 B.R. 871 (D. Mass. 1996); *Crowthers McCall Pattern, Inc. v. Lewis,* 129 B.R. 992 (S.D.N.Y. 1991); *In re Structurelite Plastics Corp.,* 224 B.R. 27 (6th Cir. B.A.P. 1998); *In re Chawley's, Inc.,* 188 B.R. 832 (Bankr. D. Minn. 1995); *In re Oxford Homes,* 180 B.R. 1 (Bankr. D. Maine 1995); *In re Aluminum Mills Corp.,* 132 B.R. 869, 885 (Bankr. N.D. Ill. 1991); *In re Morse Tool, Inc.,* 108 B.R. 389 (Bankr. D. Mass. 1989); *In re Vadnais Lumber Supply, Inc.,* 100 B.R. 127, 134-35 (Bankr. D. Mass. 1989). Under these cases, the exchange of equity for debt in a leveraged buyout situation was regarded as not amounting to fair consideration.

Unfortunately, there apparently are no North Carolina cases involving the issue of whether and under what circumstances a leveraged buyout may involve a fraudulent conveyance. However, under North Carolina law, a conveyance "is deemed to be [without consideration] when the purchaser does not pay a reasonably fair price such as would indicate unfair dealing and be suggestive of fraud." *See North Carolina Nat'l Bank v. Evans,* 296 N.C. 374, 378, 250 S.E.2d 231, 234 (1979). The record in the present case includes conflicting affidavits and other materials which create disputed issues of fact as to the value of the Debtor's assets and the amount of its liabilities at the time of the transaction with Young and the financial condition of the Debtor immediately before and immediately after the transaction. These issues of fact are material in that they have a significant bearing on the extent to which there was consideration for the promissory note and security agreement which Bonds received from the Debtor and whether the Debtor was insolvent at the time of the

transaction or was rendered insolvent by the transaction. Since there are material issues of fact regarding the fraudulent conveyance claim, defendants' motion for summary judgment as to the fraudulent conveyance claim may not be granted.

5. Fifth Claim – Avoidance of Promissory Note and Security Agreement as an Unauthorized Distribution Under G.S. § 55-6-40(c).

Under G.S. § 55-6-40(c) no distribution may be made to the shareholders of a corporation if, after giving it effect, the corporation would not be able to pay its debts as they become due in the usual course of business or the corporation's total assets would be less than the sum of its total liabilities. In the Fifth Claim the Trustee alleges that the promissory note and security agreement which Bonds received from the Debtor are avoidable under G.S. § 55-6-40(c) because, after giving effect to the promissory note and security agreement, the Debtor was not able to pay its debts as they became due in the usual course of business and the Debtor's total assets were less than the sum of its total liabilities. The Defendants seek summary judgment on this claim on the grounds that the G.S. § 55-6-40(c) is not applicable because the issuance of the promissory note and security agreement did not constitute a "distribution" for purposes of the statute and, alternatively, on the ground that the Debtor was not insolvent after the note and security agreement were issued.

In arguing that G.S. § 55-6-40(c) is inapplicable, the Defendants rely heavily on *In re C-T of Virginia, Inc.*, 958 F.2d 606 (4th Cir. 1992), a case in which the Fourth Circuit Court of Appeals held that a similar Virginia statute was

not applicable to a transaction involving a merger in which the shareholders of the debtor corporation were paid for their shares with proceeds from a loan which was secured by a lien on the assets of the debtor corporation. The court reasoned that a corporate acquisition, structured as a merger, "is simply a different animal from a distribution", noting that the payments to shareholders were not made by the debtor corporation and the encumbering of the assets occurred after the change in ownership and was not approved by the directors of the debtor corporation. There are factual differences in the present case which make the *C-T of Virginia* case inapposite. In the present case, the issuance of the promissory note and deed of trust went directly from the Debtor to Bonds, the transaction was approved by Bonds as the sole director of the Debtor and Bonds continued to be a shareholder of the Debtor following the transfer. As pointed out in the Official Comment to G.S. § 55-6-40, the definition of a "distribution" under North Carolina law is very broad: "Section 1.40 defines 'distribution' to include virtually all transfers of money, indebtedness of the corporation or other property to a shareholder in respect of the corporation's shares. It thus includes cash or property dividends, *payments by a corporation to purchase its own shares,* distributions of promissory notes or indebtedness, and distributions in partial or complete liquidation or voluntary dissolution." (Emphasis supplied). While this definition may not encompass a merger of the type involved in the *C-T of Virginia* case, it is broad enough to encompass the transaction involved in the present case.

The remaining argument regarding this claim has to do with whether the Debtor was insolvent following the transaction. This involves a disputed factual matter which

obviously is material to the merits of the claim. It follows, therefore, that the Defendants are not entitled to summary judgment with respect to the Fifth Claim.

6. Sixth Claim – Liability of Directors under G.S. § 55-8-33(a) for Distributions which Violate G.S. § 55-6-40(c).

The Sixth Claim is based upon G.S. § 55-8-33(a), which provides that a director who votes for or assents to a distribution made in violation of G.S. § 55-6-40 is personally liable for the amount of the distribution that exceeds what could have been distributed without violating G.S. § 55-6-40 if it is established that he did not perform his duties in compliance with G.S. § 55-8-30. Since this claim turns upon whether there has been a violation of G.S. § 55-6-40, the Defendants are not entitled to summary judgment for the same reasons stated in foregoing discussion of the Fifth Claim, and because the record now before the court does not reflect as a matter of law that Bonds performed his duties as a director in compliance with G.S. § 55-8-30.

7. Seventh Claim – Whether Sale Was Commercially Reasonable.

Under G.S. § 25-9-504 a secured creditor has a right to dispose of collateral after default by the debtor. G.S. § 25-9-504(3) provides that the disposition of the collateral "may be by public or private proceedings and may be made by way of one or more contracts." However, G.S. § 25-9-504(3) specifically requires that "every aspect of the disposition including the method, manner, time and terms must be commercially reasonable." G.S. §§ 25-9-601

through 25-9-607 set forth procedures for conducting public sales of collateral. These provisions deal with the content of notices of sale, posting and mailing notices of sale, etc., but are not mandatory. However, G.S. § 25-9-601 provides that if a secured party disposes of the collateral by means of a public sale which "substantially" complies with these procedures, the disposition is conclusively deemed to be commercially reasonable in all respects.

In the present case, Bonds elected to dispose of the collateral by means of a public sale which was held on August 21, 1997, at the courthouse in Cabarrus County. The Trustee alleges that the foreclosure sale was not commercially reasonable as required by G.S. § 25-9-504(3) because: (1) the notice of sale stated that the sale would be held on August 21, 1996, rather than on August 21, 1997; (2) notwithstanding having notified the Debtor that the sale would be postponed until August 29, 1997, the sale was held on August 21, 1997, as originally scheduled; (3) Bonds failed to comply with the terms of the sale which called for payment in full in cash upon completion of the foreclosure sale; and (4) the sale was held after a state court receiver had been appointed for the Debtor. Because of the alleged failure to conduct the sale in a commercially reasonable manner, the Trustee alleges that he is entitled to recover the sum of $1,484,391.11, representing the fair market value of the Debtor's assets at the time of the foreclosure sale. For the reasons hereinafter stated, the court has concluded that neither party is entitled to summary judgment on this issue.

G.S. § 25-9-602 requires that a notice of sale must: (a) refer to the security agreement pursuant to which the sale is held; (b) designate the date, hour and place of sale; (c) describe the personal property to be sold; (d) state the

terms of sale; and (e) include any other provisions required by the security agreement. Under G.S. § 25-9-603, the notice of sale must be posted on the notice bulletin board of the courthouse in which the sale is to be conducted for at least five days immediately preceding the sale and must be mailed to each debtor at its actual address if known by the secured party, the address provided by the debtor, or the debtor's last known address.

In the absence of allegations and evidence that the notice failed to comply with G.S. § 25-9-602 or the notice was not posted and mailed in accordance with G.S. § 25-9-603 or the public sale was not held as advertised, it is a question of law for the court whether the secured party has substantially complied with the procedures provided in G.S. § 25-9-601, etc. On the other hand, if there is competent evidence that the secured party did not substantially comply with the statutory procedures, then a jury issue is raised. If it is established that the secured party did not substantially comply with G.S. § 25-9-601, etc., the secured party then has the burden of proving by the greater weight of the evidence that the sale was commercially reasonable under G.S. § 25-9-504. *See Wachovia Bank & Trust Co. v. Murphy,* 36 N.C. App. 760, 245 S.E.2d 101, appeal dismissed, 295 N.C. 557, 248 S.E.2d 734 (1978); *Parks Chevrolet, Inc. v. Watkins,* 74 N.C. App. 719, 329 S.E.2d 728 (1985).

The evidence relied upon by the Trustee is sufficient to raise a jury issue as to whether Bonds substantially complied with the requirements of G.S. § 25-9-601 in noticing and conducting the purported sale which was held on August 21, 1997, but does not show as a matter of law that Bonds did not substantially comply or as a matter of law that the sale was not commercially reasonable. The

evidence submitted by the Trustee in support of his motion shows that the notice of sale which was prepared on behalf of Bonds used an improper date for the sale when it referred to August 21, 1996, instead of August 21, 1997. The evidence also showed that after the original notice was issued, a notice of postponement was sent to the Debtor purporting to postpone the sale to August 29, 1997. Then, shortly before the sale, and after receiving conflicting verbal information as to whether the sale would be postponed, the Debtor was notified by representatives of Bonds that the sale would be held as originally scheduled. The evidence also would support a finding that the bid at the sale was made on behalf of Bonds, Inc., rather than Bonds, raising an issue as to whether a credit bid was permissible, rather than Bonds, Inc., being obligated to pay cash as called for under the terms stated in the notice of sale. Substantial compliance means "a compliance which substantially, essentially, in the main, or for the most part, satisfies the procedures." *North Carolina Nat'l Bank v. Burnette,* 297 N.C. 524, 532, 256 S.E.2d 388, 393 (1979). Considering all of the foregoing circumstances surrounding the sale, the court concludes that reasonable minds could differ as to whether the sale substantially complied with the applicable statutory provisions. The foregoing circumstances, plus the fact that the receiver was in place at the time of the sale, lead to the same conclusion regarding the issue of whether all aspects of the sale were commercially reasonable. The issue of commercial reasonableness "does not readily lend itself to summary judgment, as reasonable minds may differ over what is commercially reasonable." *NationsBank of N.C., N.A. v. American Doubloon Corp.,* 125 N.C.App. 494, 499, 481 S.E.2d 387, 390, *cert. denied,* 346 N.C. 882, 487 S.E.2d 551

(1997). It follows therefore that neither party is entitled to summary judgment with respect to the Seventh Claim.

8. Eighth Claim – Whether Bonds, Inc. was alter Ego or Mere Instrumentality of Bonds.

Defendants presented no arguments in support of their motion for summary judgment as to this claim, and it does not appear from the record that they are entitled to summary judgment as to this claim. Accordingly, Defendants' motion for summary judgment will be denied as to the Trustee's Eighth Claim.

9. Ninth Claim – Breach of Fiduciary Duties.

G.S. § 55-8-30 requires that a director discharge the duties of a director in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances and in a manner the director reasonably believes to be in the best interest of the corporation. Although the word "fiduciary" is not used in this provision, the North Carolina Commentary to § 55-8-30 points out that "there is no intent to change North Carolina law in this area. The decision not to bring forward the language stating that a director shall 'be deemed to stand in a fiduciary relation to the corporation' in former G.S. 55-35 is not intended to modify in any way the duty of directors recognized under the former law." The earlier cases which discuss and delineate the duties of directors thus continue to be effective. Under these cases directors act in a fiduciary capacity in the sense of owing the corporation the duties of good faith, loyalty and due care. *See Hill v. Erwin Mills, Inc.*, 239 N.C. 437, 80 S.E.2d 358

(1954); *Loy v. Lorm Corp.*, 52 N.C. App. 428, 278 S.E.2d 897 (1981). According to *Robinson,* the primary duty of a director is good faith. Such duty demands that the director always discharge his or her duties honestly, conscientiously, fairly, and with undivided loyalty to the corporation. R. Robinson, *North Carolina Corporation Law,* § 14-2 (15th ed. 1995). The requirement in G.S. § 55-8-30(a)(3) that a director act in a manner he reasonably believes to be in the best interest of the corporation prohibits a director from using his position for his own personal gain to the detriment of the corporation or its shareholders. *See id.*

The evidence in the record now before the court reflects that Bonds was a director of the Debtor at the time of the transaction with Young and that Bonds continued as a director of the Debtor following the transaction. In alleging that Bonds breached the fiduciary duties which he owed to the Debtor, the Trustee relies primarily upon the fact that Bonds appro d the transaction with Young in his capacity as a director. The Trustee points out that Bonds had a personal interest in the transaction arising from the fact that the corporation was acquiring 35,999 shares of his stock in the transaction. The Trustee argues that in approving the transaction, "Bonds breached his fiduciary duties of fidelity and due care to the Debtor and is responsible for the financial distress caused to the Debtor as a result of his actions in that regard." A claim for breach of fiduciary duty may arise from directors approving and/or participating in a leveraged buyout transaction, depending upon the terms and conditions of the transaction and the effect of the transaction upon the corporation. *See In re Healthco Int'l, Inc.,* 208 B.R. 288 (D. Mass. 1996); *In re Buckhead Am. Corp.,* 178 B.R. 956

(Bankr. D. Del. 1994). These cases recognize that a transaction involving a purchase or redemption of stock which renders the corporation insolvent or with unreasonably small capital threatens the very existence of the corporation and may give rise to a claim against the directors who approve the transaction. It is undisputed that Bonds was a director and that he approved the transaction with Young. However, the financial condition and solvency of the Debtor, before and after the transaction, which are material in any such claim, are matters which are in sharp dispute in the present case. Moreover, based upon the circumstances disclosed by the evidence submitted by the parties, matters such as whether Bonds exercised the care of an ordinarily prudent person in a like position, whether he acted in good faith, whether he reasonably believed the transaction to be in the best interest of the corporation and whether the transaction was fair from the standpoint of the Debtor, are matters about which reasonable minds could differ and which, more appropriately, are for a jury to determine. It follows that neither party is entitled to summary judgment on the issue of whether Bonds breached his duty as a director by approving the transaction with Young.

The same is true with respect to the issue of whether Bonds breached his duties to the corporation when he foreclosed on the corporate assets in August of 1997. The foreclosure involved a matter in which Bonds had an interest adverse to that of the Debtor. Under G.S. § 55-8-31, a conflict of interest transaction in which a director has a direct or indirect interest is not voidable if the material facts of the transaction and the director's interest were disclosed or known to the board of directors or the shareholders and the board of directors or shareholders

authorized, approved, or ratified the transaction. In arguing for summary judgment, the Defendants say that Young, the other director of the Debtor, ratified the transaction. However, the language of G.S. § 55-8-31 requires the affirmative vote of the ratifying directors and the record now before the court does not disclose that any formal vote of directors was ever taken with respect to the approval of Bonds exercising his security interest in August of 1997.

10. Tenth Claim – Successor Liability.

The general rule under North Carolina law is that the purchaser of all or substantially all the assets of a corporation is not liable for the debts of the old corporation. *See Budd Tire Corp. v. Pierce Tire Co.,* 90 N.C. App. 684, 370 S.E.2d 267 (1988). However, North Carolina recognizes four exceptions to this general rule: (1) Where there is an express or implied agreement by the purchasing corporation to assume the debt or liability; (2) where the transfer amounts to a *de facto* merger of the two corporations; (3) where the transfer of assets was done for the purpose of defrauding creditors; and (4) where the purchasing corporation is a "mere continuation" of the selling corporation in that the purchasing corporation has the same shareholders, directors and officers. *See GP Publications, Inc. v. Quebecor Printing – St. Paul, Inc.,* 125 N.C. App. 424, 432-33, 481 S.E. 674 (1997), *rev. denied,* 346 N.C. 546, 488 S.E.2d 800 (1997). In the present case, the Trustee relies upon the "mere continuation" exception in alleging that Bonds, Inc., should be held liable for the debts of the Debtor.

In the context of a commercially reasonable sale under G.S. § 25-9-504, North Carolina follows the "traditional rule" regarding "mere continuation" theory of liability. Under the "traditional rule" as applied in North Carolina, a corporate successor is the continuation of its predecessor if only one corporation remains after the transfer of assets and there is identity of stockholders and directors between the two corporations. However, North Carolina recognizes two other factors in addition to the issue of continuity of ownership that may be considered in deciding whether liability should be imposed on the successor corporation: (1) inadequate consideration for the purchase; and (2) lack of some of the elements of a good faith purchaser for value. *See GP Publications,* 125 N.C. App. at 434; 481 S.E.2d at 680.

Based upon the record now before the court, the Trustee is not entitled to summary judgment against Bonds, Inc., on the theory that Bonds, Inc., is a mere continuation of the Debtor. Under the traditional rule regarding mere continuation liability the plaintiff is required to show identity of stockholders and directors between the former corporation and the successor corporation. The record does not establish such identity as a matter of law in the present case. The record reflects that prior to November of 1995, Bonds was the sole shareholder and director of the Debtor. However, the situation changed in November of 1995 with the closing of the transaction involving Young. At that time Young acquired 4000 shares of the stock owned by Bonds and 35,999 shares of Bonds' stock were redeemed, leaving Bonds with only one share of stock. Although Bonds remained as a director of the Debtor, the record reflects that there were two directors other than Bonds who were selected by Young. While

Bonds did receive a security interest in the stock which was sold to Young as a result of the stock being pledged and placed in escrow, the fact remains that Young was the owner of the stock and exercised the rights incident to ownership of the stock by electing directors, exercising control over the Debtor and operating its business following the closing. This is the situation which existed from November of 1995 until the foreclosure sale in August of 1997. If measured by identity of stockholders and directors, Bonds, Inc., was not a continuation of the Debtor because there was a marked difference between the shareholders and directors of Bonds, Inc., and those of the Debtor. Young, the principal shareholder of the Debtor at the time of the sale, owned no stock in Bonds, Inc., all of which was owned by Bonds. None of the directors of the Debtor became directors of Bonds, Inc., other than Bonds. These facts do not establish as a matter of law that there was an identity of shareholders and directors between the two companies.

The two factors other than continuity of ownership which may be considered in deciding whether to impose liability upon a successor corporation are inadequate consideration for the purchase and lack of some of the elements of a good faith purchaser for value. The record now before the court, at most, raises a jury issue as to whether Bonds, Inc., was a "good faith" purchaser and whether the consideration at the foreclosure sale was inadequate. It is for the trier of fact to determine whether these factors have been established and, if so, to weigh the factors in determining whether Bonds, Inc., was a mere continuation of the Debtor. Hence, these additional factors are not sufficient to support the conclusion that, as a matter of law, Bonds, Inc., was a mere continuation of the

Debtor. Instead, jury issues are raised, which mean that neither of the parties are entitled to summary judgment on this claim.

11-14. Twelfth through Fourteenth Claims.

Although the defendants included these claims in their motion for summary judgment, defendants presented no arguments in support of summary judgment as to these claims and it does not appear that defendants are entitled to summary judgment as to these claims. Defendants' motion for summary judgment as to the Twelfth through Fourteenth Claims therefore will be denied.

15. Third-party Defendant's Motion for Summary Judgment.

The third-party defendant ("Mills") argues that he is entitled to summary judgment dismissing the professional malpractice claim asserted by Bonds because: (1) the undisputed evidence shows that his employment and professional duty was limited to reviewing the closing documents and attending the closing on behalf of Bonds, and did not extend to analyzing the financial structure of the transaction; (2) even if Bonds shows that Mills breached a duty owed to him, Bonds failed to prove that such breach was a proximate cause of his damages; (3) Bonds had a duty to mitigate his damages which would have eliminated his damages and his failure to do so subjects his claim against Mills to summary judgment; (4) Bonds' claim is subject to summary judgment because he failed to create a genuine issue of material fact indicating that the financing statements were insufficient to perfect a security interest; and (5) Bonds' failure to exercise his

rights as a creditor under the closing documents constitutes contributory negligence as a matter of law.

It is undisputed that Mills was employed to act as attorney for Bonds to some extent with respect to the transaction involving Young. While disputing that his engagement extended to "reviewing the underlying transaction", Mills concedes in his first affidavit that he was employed to review the "paperwork" for the transaction and attend the closing on behalf of Bonds. In accepting such employment, Mills impliedly represented that (1) he possessed the requisite degree of learning, skill and ability necessary to the practice of his profession and which others similarly situated ordinarily possess; (2) he would exert his best judgment in reviewing the closing documents and representing Bonds at the closing; and (3) he would exercise reasonable and ordinary care and diligence in the use of his skill and in the application of his knowledge to reviewing the closing documents and attending the closing on behalf of Bonds. *See Hodges v. Carter,* 239 N.C. 517, 519, 80 S.E.2d 144, 146 (1954).

The evidence reflects without dispute that the "paperwork" for the transaction included the financing statement that ultimately was recorded with the Secretary of State and that this financing statement therefore was one of the documents which Mills reviewed or should have reviewed. It is, of course, undisputed that the financing statement did not contain the address for Bonds, and it is a fair inference from the evidence submitted by the parties that Mills did not make any suggestion or recommendation that this obvious omission be corrected and the financing statement remained incomplete when it was recorded. As a result of the omission of the secured party's address, the financing statement did not comply with the

minimal statutory requirements and was insufficient to perfect Bonds' security interest in the Debtor's assets. Based upon these circumstances, the court is satisfied that even if Mills' employment was limited to reviewing the closing documents and attending the closing, a rational trier of facts could conclude that Mills failed to satisfy the professional duty to Bonds and that such failure was a proximate cause of damage to Bonds. Based upon the record in the present case, a trier of fact could rationally conclude that an attorney who possessed the requisite degree of learning, skill and ability necessary to review closing documents of the type involved in this case and which other attorneys similarly situated ordinarily possess would know or ascertain before the closing that one of the requirements of a financing statement is that it supply the addresses of the parties and that if such attorney exerted his best judgment and exercised reasonable and ordinary care and diligence, he would have observed that one of the financing statements did not include the address of the secured party and would have seen to the correction of such omission before the financing statement was recorded. Since the uncorrected omission resulted in the security interest not being perfected, a rational trier of fact also could conclude that the breach of duty by Mills was a proximate cause of damages to Bonds.

Whether Bonds failed to satisfy a duty to mitigate his damages or was contributorily negligent are not matters which are appropriate for summary judgment. In arguing for summary judgment on these grounds, Mills relies upon the general rule that in a negligence action, a plaintiff has a duty to use due care in minimizing his loss and may not recover damages which could have been prevented through the plaintiff's reasonable efforts. Whether Bonds,

a lay person, should have exercised his legal rights at a different time or in a different manner in order to have exercised "due care" or to have made "reasonable efforts" to avoid or minimize his damages, at most, is a question about which reasonable minds could differ and is a matter for jury determination and not summary judgment. Since Mills is not entitled to summary judgment based upon the employment which he admittedly undertook, his motion for summary judgment must be denied without regard to whether his employment extended to other matters and, if so, whether he satisfied his professional duty as to those matters.

CONCLUSION

An order in accordance with the foregoing findings and conclusions will be entered contemporaneously with the filing of this memorandum opinion.

This 31st day of March, 2000

William L. Stocks
WILLIAM L. STOCKS
United States Bankruptcy Judge

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

No. 01-2025
BK-97-52130C-7W
CA-01-80-1

(Filed August 9, 2002)

In RE: BONDS DISTRIBUTING COMPANY, INCORPORATED

Debtor

BRUCE MAGERS, Trustee for Bonds Distributing Company, Incorporated;

Plaintiff-Appellee

and

WILLIAM L. MILLS, III, d/b/a The Mills Law Firm

Third Party Defendant-Appellee

v.

BONDS, INCORPORATED;

Defendant-Appellant

and

DONALD R. BONDS

Defendant & Third Party Plaintiff-Appellant

No. 01-2503
CA-01-80-1
BK-97-52130C-7W

In Re: BONDS DISTRIBUTING COMPANY, INCORPORATED

Debtor

WILLIAM L. MILLS, III, d/b/a
The Mills Law Firm

Third Party Defendant-Appellant

and

BRUCE MAGERS, Trustee for Bonds
Distributing Company, Incorporated

Plaintiff

v.

BONDS, INCORPORATED;

Defendant-Appellee

and

DONALD R. BONDS

Defendant & Third Party
Plaintiff-Appellee

On Petition for Rehearing and Rehearing En Banc

The petition for rehearing and rehearing en banc filed by Bruce Magers was submitted to this Court. As no member of this Court or the panel requested a poll on the petition for rehearing en banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied.

IT IS ORDERED that the petition for rehearing and rehearing en banc is denied.

For the Court,

/s/ Patricia S. Connor
CLERK

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(2)

No. 02-584

Supreme Court, U.S.
FILED
NOV 12 2002
CLERK

In The

Supreme Court of the United States

BRUCE MAGERS, TRUSTEE IN BANKRUPTCY FOR BONDS DISTRIBUTING COMPANY, INC.,

Petitioner,

v.

DONALD R. BONDS, BONDS, INC., and WILLIAM L. MILLS, III,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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12 pp

CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Donald R. Bonds and Bonds, Inc., state that Bonds, Inc. is a privately held North Carolina corporation. None of its shares is held by a publicly traded company.

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STATEMENT OF THE CASE BY DONALD R. BONDS AND BONDS, INC.

In a nutshell, this case arose from an action against Donald R. Bonds ("Mr. Bonds") and Bonds, Inc. by Bruce Magers, the Chapter 7 bankruptcy trustee for a debtor corporation, Bonds Distributing Company, Inc. ("BDI"). The action sought, among other things, to invalidate a security interest which Mr. Bonds had obtained with respect to the assets of BDI. This security interest was granted to Mr. Bonds incident to a leveraged buyout of his stock in BDI by one Steven Young ("Mr. Young"). After approximately 18 months of management under Mr. Young, BDI became insolvent and was placed into involuntary bankruptcy by its creditors. As part of the payment for his stock, which had been redeemed by BDI incident to the buyout, Mr. Bonds accepted a stock purchase note from BDI. BDI defaulted upon the note, and Mr. Bonds foreclosed upon his security interest in BDI's assets.

The trustee sought to invalidate the foreclosure and to reclaim from Mr. Bonds, pursuant to 11 U.S.C. §544, the money equivalent of the assets which he had foreclosed upon. The grounds for this claim were as follows:

Under former North Carolina General Statute ("N.C.G.S.") §25-9-401(a)(c),[1] a financing statement evidencing a security interest had to be filed in 2 places: (a) in the office of the North Carolina Secretary of State, and (b) in the public registry of the county where the debtor

[1] N.C.G.S. §25-9-401 is a part of North Carolina's version of the Uniform Commercial Code ("the Code"). The portion of the Code involved in this case is that governing secured transactions (Article 9).

had its place of business.[2] In this case, it was undisputed that the financing statement filed on behalf of Mr. Bonds with the Secretary of State, while setting forth his name as the secured party, omitted his address. The locally filed financing statement, on the other hand, did include Mr. Bonds' address. The trustee's complaint alleged that the omission of Mr. Bonds' address from the centrally filed financing statement rendered invalid his security interest in the assets of BDI. The complaint alleged numerous other causes of action as well, but all of these other claims were dismissed by the trustee prior to trial. Therefore, the dismissed claims, while referred to in the trustee's petition, are not relevant hereto.

The Bankruptcy Court below granted summary judgment for the trustee on his financing statement claim, holding that the omitted address constituted a fatal defect rendering Mr. Bonds' security interest void. This decision was affirmed by the District Court on appeal without any substantive comment.

This decision was reversed by the Fourth Circuit Court, which found that the omitted address did not constitute a fatal defect in the perfection of Mr. Bonds' security interest. The Fourth Circuit held that the thrust of the North Carolina decisions dealing with the adequacy

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[2] North Carolina has now revised its statutory filing scheme for financing statements. Under the current North Carolina version of Article 9 of the Uniform Commercial Code, a financing statement covering ordinary goods that do not qualify as fixtures or "extracted collateral" is to be filed with the Secretary of State. N.C.G.S. §25-9-501. Therefore, references herein to N.C.G.S. §§25-9-401 and 402 are to provisions of North Carolina law that are not now in effect, but were in effect at the time of the events referred to above.

of financing statements was to the effect that such an omission would not have seriously misled a reasonably diligent record searcher, because the financing statement had been accepted for filing and would have given clear notice of the existence of a prior security interest.[3] The centrally filed financing statement, therefore, fulfilled the underlying policy rationale of former N.C.G.S. §25-9-401; i.e., to give reasonable notice to third parties of the possible existence of prior security interests in property.

REASONS FOR DENYING THE WRIT

I. The Decision of the Fourth Circuit Court Was Correct.

The current petition alleges that the opinion of the Fourth Circuit Court of Appeals "Completely Ignores the Plain Language and the Commentary of Applicable North Carolina Statutes and Misapplies Applicable North Carolina Precedent." This is not so. The Circuit Court's decision specifically took into account all of the North Carolina statutory provisions which were pertinent to the issue presented.

Furthermore, as noted by the Circuit Court, the Bankruptcy Court, in its effort to find favorably for the trustee, searched far and wide for any decision from any

[3] The North Carolina courts have not, to this point, decided a case posing the precise issue of law presented below. Therefore, the function of the Bankruptcy Court (and the District Court) was to predict, on the basis of existing decisions, how the North Carolina courts would rule if confronted with such issue.

jurisdiction that might deem the missing address to be a fatal defect. In this effort, it completely lost sight of the fact that its duty was to predict the application of the law of North Carolina, NOT that of some other state. The Bankruptcy Court simply disregarded the North Carolina decision in *E. B. Grain Co. v. Denton*, 73 N.C.App. 14, 325 S.E.2d 522 (1985), which held that an address for the secured party that was as general as "Whitakers, NC" substantially complied with the requirements for a valid financing statement. The *E. B. Grain Co.* decision clearly indicates that the North Carolina courts would likely hold that a financing statement which omitted an address for the secured party, but which clearly identified that party, would nonetheless be an adequate compliance with N.C.G.S. §25-9-402. The reason: the financing statement would give clear notice to third parties of the possible existence of a prior subsisting security interest.[4]

The trustee cites *In re: Seventeen S. Garmet Co.*, 145 B.R. 511 (E.D.N.C. 1999), and *In re: Environmental Aspecs, Inc.*, 235 B.R. 378 (E.D.N.C. 1999) as standing for

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[4] The following decisions, applying North Carolina law, stand for the proposition that as long as the "reasonable notice" policy underlying N.C.G.S. §25-9-402 is met, omissions from a financing statement that would not seriously mislead a record searcher do not constitute fatal defects: *Evans v. Everett*, 279 N.C. 352, 183 S.E.2d 109 (1971); *In re: Bumper Sales, Inc.*, 907 F.2d 1430 (4th Cir. 1990). See also: the Official Commentary to N.C.G.S. §25-9-402, which states: "This section adopts a 'notice filing' system. . . . Under such a system, the security agreement proper need not be registered; a financing statement containing such general information as is deemed sufficient to put a party searching the record on notice that there is a security agreement outstanding against a particular person covering certain types of collateral is all that need be filed. . . ."

the proposition that the North Carolina courts would hold invalid a financing statement that omitted an address for the secured party. However, those cases did not deal with that issue, and are not applicable to this case. They dealt instead with financing statements which omitted the *debtor's name*. Such a situation is not at all like that presented here. A record searcher finding a financing statement with no name for the debtor would be seriously misled, and that is totally unlike the situation presented in this case.

The petitioner's contention that the Fourth Circuit Court ignored or "misapplied" the law in this case is without merit. The Circuit Court's decision was based upon a clearly reasoned and logical analysis of the law of North Carolina, and is correct. Furthermore, this Court has held that it will ordinarily accept as correct the decisions of Courts of Appeals concerning state laws. *Richards v. United States*, 82 S.Ct. 585, 369 U.S. 1, 7 L.Ed.2d 429 (1962). And the current petition contains no adequate showing of any substantive error by the Fourth Circuit Court warranting the exercise of this Court's discretionary jurisdiction.

II. This Case Does Not Involve Issues Which Necessitate Resolution of Splits of Authority Between the Circuits.

The petitioner asserts that the writ should be granted so that this Court may resolve a split of authority between the Ninth and Fourth Circuits regarding the interpretation of §9-402 of the Uniform Commercial Code. This argument is without merit for the following reasons:

In 2000, North Carolina and a majority of the other states substantially revised their versions of Article 9 of the Code. Specifically, the requirements concerning what must be included in a financing statement and where it must be filed were completely rewritten. Therefore, there is no need for this Court to expend its time and resources to resolve a split of authority in the interpretation of a statute which no longer exists.

Furthermore, the Code, as adopted in varying versions by the states, constitutes state – not federal – law. What the petitioner invites this Court to do is, in effect, to "enact" a uniform, nationwide interpretation of a portion of a law adopted by the various states. Such action would violate basic principles of federalism and should not be countenanced.

III. There Is No Compelling Reason For This Court To Exercise Its Discretionary Authority To Review the Fourth Circuit Court.

The case *sub judice* involves interpretation of "garden variety" North Carolina commercial law. It does not involve the construction of any federal statute or administrative regulation, nor does it involve a determination of the Constitutionality of any state or federal statute or regulation. It has nothing to do with any treaty or international agreement and does not involve any claim by or against the federal government. In short, it contains no dispute the *gravamen* of which would call for an exercise by this Court of its discretionary jurisdiction.

CONCLUSION

For the foregoing reasons, Donald R. Bonds and Bonds, Inc. urge that the petition be denied.

This the 11th day of November, 2002.

Respectfully submitted,

DOZIER, MILLER, POLLARD & MURPHY, LLP

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APPENDIX

N.C.G.S. §25-9-401: Place of filing; erroneous filing; removal of collateral.

(1) The proper place to file in order to perfect a security interest is as follows: . . .

(c) in all other cases, in the office of the Secretary of State and in addition, if the debtor has a place of business in only one county of this State, also in the office of the register of deeds of such county, or, if the debtor has no place of business in this State, but resides in the State, also in the office of the register of deeds of the county in which he resides.

N.C.G.S. §25-9-402: Formal requisites of financing statement; amendments; mortgage as financing statement.

(1) A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security may be obtained, gives a mailing address of the debtor and contains a statement indicating that types, or describing the items, of collateral. . . .

(8) A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading.

Supreme Court, U.S.
FILED
NOV 15 2002
OFFICE OF THE CLERK

No. 02-584

In The Supreme Court of the United States

BRUCE MAGERS, TRUSTEE IN BANKRUPTCY FOR BONDS DISTRIBUTING COMPANY, INC.,

Petitioner,

v.

DONALD R. BONDS, BONDS, INC., and WILLIAM L. MILLS, III,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

RESPONDENT WILLIAM L. MILLS, III'S BRIEF IN OPPOSITION

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STATEMENT OF THE CASE

In addition to the statement of facts set forth in the petition, the following undisputed facts should be noted:

Respondent William L. Mills, III[1] (hereinafter "Mills") is an attorney who was retained by Donald R. Bonds ("Bonds") to represent him in certain limited respects with regard to the November 7, 1995 sale of Bonds Distributing Company, Inc. ("BDI") to Stephen H. Young (hereinafter "Young"). Young had his own separate legal counsel, who served as the closing attorney. Following the closing, UCC-1 financing statements perfecting Bonds' security interest in the assets of BDI were filed with both the Register of Deeds of Cabarrus County, North Carolina by Mills, and with the North Carolina Secretary of State in Raleigh, North Carolina by Young's attorney. Although the UCC-1 filed by Young's attorney with the Secretary of State did not contain an address for Bonds, it was accepted and filed by that office. In addition, the UCC-1 filed in Cabarrus County by Mills contained a full address for Bonds as the secured party and was otherwise complete. Bonds had been in business in Cabarrus County for decades, and after the sale Bonds continued to maintain an office and presence at BDI, the address for which was listed in both filings.

---

[1] In the lower courts and the Fourth Circuit, Mills contested subject matter jurisdiction and asserted that neither the Bankruptcy Court nor the District Court had jurisdiction over the third-party claims asserted against him by Bonds under 28 U.S.C. § 1334 or any other statutory provision, which issue was rendered moot by the circuit court ruling.

REASONS FOR DENYING THE PETITION

The sole question presented by the petition is whether a UCC-1 financing statement that omits only the secured party's address on the central filing, but includes the address on the local filing and is otherwise complete in all respects, substantially complies with the requirements and fulfills the notice purpose of former North Carolina General Statute § 25-9-402 (1995).[2] The Fourth Circuit correctly held that it did.

First, petitioner argues that the decision from the Fourth Circuit conflicts with an opinion from the Ninth Circuit in *In re Softalk Publishing Co., Inc.*, 856 F.2d 1328 (9th Cir. 1988). However, the Ninth Circuit's opinion does not hold what petitioner claims, but rather confirms the notice purpose of the statute consistent with North Carolina precedent as followed by the Fourth Circuit, as well as opinions from other federal courts. Accordingly, the petition must be denied.

Second, petitioner asserts that the Fourth Circuit's decision incorrectly applies North Carolina statutes and precedent. To the contrary, not only is the Fourth Circuit's opinion firmly in keeping with North Carolina law, but the applicable statute has since been revised and addresses the issue presented in this case. The revision supports the decision below and eliminates any need for review of the issue presented by the petition.

---

[2] The statute was revised in 2001 as set forth below, which renders moot the issue presented by this case.

Accordingly, for the reasons set forth herein, respondent Mills respectfully submits that the Fourth Circuit's ruling was proper and that the petition for writ of certiorari should be denied.

I. The Fourth Circuit's Opinion Is Consistent With Decisions From Other Circuits, Including The Ninth Circuit.

Petitioner's asserted conflict between the Fourth Circuit's decision in this case and the Ninth Circuit decision in *In re Softalk* is artificial. A close review of both opinions demonstrates their harmony on key principles. First, both opinions emphasize the notice purpose of the UCC statute. The Ninth Circuit described it as follows:

> The financing statement serves to give notice to other creditors or potential creditors that the filing creditor might have a security interest in certain assets of the name debtor.
>
> * * *
>
> The financing statement . . . serves merely to alert third parties to inquire further; it therefore need not offer exhaustive details. "[T]he policy of [the Code is] to simplify formal requisites and the filing requirements and is designed to discourage the fanatical and impossibly refined reading of such statutory requirements in which courts have occasionally indulged themselves."

In re Softalk, 856 F.2d at 1330.

Second, both opinions adopt a holistic view of substantial compliance under the statute. As the Ninth Circuit noted, "[b]efore subsection 9402(8) will save a financing statement that contains errors, however, that financing

statement must substantially comply with the remainder of section 9402." *Id.* at 1331. The court further articulated its role as determining "whether the financing statement as a whole complies with section 9402." *Id.* at 1332. Therefore, the opinions agree on the fundamental notice purpose of the statute and the primary approach to the issue of substantial compliance therewith.

Moreover, the specific issue addressed in *In re Softalk* was different than the one decided by the Fourth Circuit in the present case. *In re Softalk* addressed the requirement that a financing statement contain a statement of the collateral covered thereunder. Specifically, the court in *In re Softalk* considered whether a financing statement which listed a security interest in "proceeds" adequately identified and perfected a security interest in "collateral." *Id.* at 1331. Noting the difference in those terms as defined under the UCC, the court held that potential creditors were entitled to rely on the accepted definitions, and thus the security interest was not perfected. *Id.* at 1332.

> A potential third party creditor encountering one of those terms in a bare-bones document such as a financing statement is entitled to rely on the accepted statutory meaning of that term in the absence of explicit language to the contrary apparent on the face of the financing statement itself. First City's financing statement contains no such contrary language.

Id. As implied by the Ninth Circuit, a statement of the collateral encumbered by a financing statement is more fundamental to the notice purpose than is information about the secured party's address.

Finally, the court limited its ruling to the specific facts presented. *Id.*

> Perhaps First City would have a valid argument if it had used some label other than "proceeds" to misdesignate its statement of collateral. That is not the situation in this case, however, and we express no opinion about the sufficiency of a financing statement that misdesignates the statement of collateral as something other than "proceeds."

Id.

Accordingly, there is no conflict between the circuits on the issue presented. In fact, the Fourth Circuit's opinion in the present case is likewise consistent with opinions from the Tenth Circuit, *Rooney v. Mason*, 394 F.2d 250 (10th Cir. 1968) (holding that absence of address for secured party does not invalidate financing statement), and the Fifth Circuit, *Matter of Bankrupt Estate of Smith*, 508 F.2d 1323 (5th Cir. 1975) (holding that absence of street address for debtor did not invalidate financing statement). As a result, the petition for writ of certiorari should be denied.

II. The Fourth Circuit Properly Applied North Carolina Statutes And Precedent.

Petitioner's argument that the Fourth Circuit failed to follow North Carolina law likewise lacks merit. The UCC uses a system of notice filing that allows for minor errors in filing. The statute "adopts a system of notice filing. . . . The notice itself indicates merely that the secured party who has filed may have a security interest in the collateral described." N.C.G.S. § 25-9-402, Official Comment. In fact,

the financing statement need only be a "skeletonic statement" that the parties intend to engage in further transactions. *Evans v. Everett*, 279 N.C. 352, 356, 183 S.E.2d 109, 112 (1971).

North Carolina General Statute § 25-9-402 (1995) provides that "a financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading." N.C.G.S. § 25-9-402(8) (1995). Those requirements, at the time of the transaction at issue, were (1) the names of the debtor and the secured party, (2) the signature of the debtor, (3) "an address of the secured party from which information concerning the security interest may be obtained," (4) a mailing address of the debtor, and (5) a statement of collateral. N.C.G.S. § 25-9-402(1) (1995). The policy of notice filing can be seen throughout North Carolina precedent with regard to each of these requirements, and further reveals that minor errors in any of the requirements will not be fatal to perfection.

First, neither the name of the debtor nor the secured party must be exact in order to have a valid financing statement. For example, *In re Environmental Aspecs, Inc.*, 235 B.R. 378 (E.D.N.C. 1999), involved an adversary proceeding brought by the debtor EAI (parent) and EAI of NC (subsidiary) to determine the priority of security interests held by creditors SouthTrust and AAL in EAI of NC's property. SouthTrust filed financing statements in 1994 naming the debtor as EAI. *Id.* at 382. Later, in 1997, SouthTrust filed additional financing statements naming EAI of NC as the debtor. *Id.* at 383. In the interim, in 1996, AAL filed financing statements naming EAI as the debtor but attaching security agreements identifying the

debtor as EAI of NC. *Id.* at 383. The bankruptcy court held that AAL's lien had priority over that of SouthTrust. *Id.* at 382.

The district court affirmed. Upholding the UCC system of notice filing, the court held that the omission of the words "of North Carolina" on AAL's financing statement was not seriously misleading because the true identity of the debtor could be ascertained from an examination of the documents attached to the financing statement. *Id.* at 386. The court further held that SouthTrust's financing statement filed in 1994 was not effective because it was not signed by EAI of NC as the debtor. *Id.* at 388. *See also Matter of Southern Supply Company of Greenville, North Carolina, Inc.*, 405 F. Supp. 20 (E.D.N.C. 1975) (identification of debtor Southern Supply Company of Greenville, N.C., Inc. on the financing statement as Southern Supply Co. was not seriously misleading because the notice purpose was accomplished).

In addition, with regard to information about the secured party, the Fourth Circuit previously upheld the spirit of the statute and notice filing in the case of *In re Bumper Sales, Inc.*, 907 F.2d 1430 (4th Cir. 1990). In that case, the debtor borrowed money from Marepcon, whose trade name was Norshipco. *Id.* at 1432. Bumper Sales granted Marepcon a security interest, and Marepcon filed one financing statement listing it as the secured party and two others listing Norshipco as the secured party. *Id.* The unsecured creditors committee filed an objection challenging the proper perfection of Marepcon's security interest. *Id.* at 1433. The bankruptcy court held the security interest to be valid and perfected, and the district court affirmed. *Id.*

On appeal to the Fourth Circuit, the committee argued that the financing statements were seriously misleading because of the identity of Marepcon in one and the trade name Norshipco in the others. *Id.* at 1434. The Fourth Circuit rejected that argument, stating the issue was "whether or not 'a reasonably diligent searcher' would be misled by the irregularity." *Id.* at 1434. The court then drew a distinction between the purpose of information about the debtor and the secured party.

> [T]he use of the secured party's (as opposed to the debtor's) trade name is much less troubling, in part because the financing statement still gives notice that the debtor's assets may be encumbered and that further inquiry is warranted. [citations omitted]. Consistent with this thinking, the UCC does not require the secured party to refile a financing statement upon any post-filing changes in the secured party's name or identity, whereas it does impose a responsibility in certain circumstances to refile when the debtor's name changes. Va.Code § 8.9-402(7).

Id. at 1435.

Accordingly, the court held that the financing statements were not seriously misleading and gave sufficient notice to any prospective creditor. *Id. See also Rooney v. Mason*, 394 F.2d 250 (10th Cir. 1968) (upholding a financing statement omitting addresses of debtor and secured party because purpose of notice was satisfied in that addresses were readily obtainable and known).

Second, North Carolina courts have even permitted leniency with regard to the debtor's signature. *See, e.g., Mountain Farm Credit Service, ACA v. Purina Mills, Inc.*, 119 N.C. App. 508, 459 S.E.2d 75 (1995). In *Mountain*, two

secured parties, Purina Mills ("Purina") and Mountain Farm Credit Service ("MFCS"), claimed entitlement to proceeds from the sale of debtor's cattle. *Id.* at 509, 459 S.E.2d at 77. Debtor sold its cattle and paid MFCS, but did not pay Purina because debtor did not consider it a creditor. *Id.* Purina had obtained a security agreement and filed a financing statement; however, it was only signed by one partner and listed as the debtor the two partners individually doing business as the partnership. *Id.* at 511, 459 S.E.2d at 78. MFCS contended that Purina's security interest in the debtor was flawed because the partner signed as an individual not authorized to so sign, and the debtor was listed incorrectly. *Id.* Purina demanded payment from MFCS, which then brought a declaratory judgment action to determine who was entitled to the proceeds. *Id.* at 509, 459 S.E.2d at 77.

The trial court held that Purina's security interest was perfected and Purina was entitled to receive the proceeds from MFCS. *Id.* at 501, 459 S.E.2d at 78. The North Carolina Court of Appeals reiterated the purpose of a financing statement to provide notice to third parties of the debtor-creditor relationship. *Id.* at 513, 459 S.E.2d at 80. The court found that the correct debtor was listed in the debtor box and a search request under debtor's name located Purina's financing statement. *Id.* The court further found sufficient evidence that the partner's signature was made on behalf of the partnership and that he was authorized to sign. *Id.* at 513, 459 S.E.2d at 79. Thus, the court held that this comported with the statutory requirements, and that the financing statement was perfected. *Id.* at 514, 459 S.E.2d at 79.

Recently, in *In re Lea Lumber & Plywood LLC*, 266 B.R. 342 (E.D.N.C. 2001), the United States Bankruptcy

Court for the Eastern District of North Carolina held perfected a financing statement that was signed by an individual employed by the debtor's manager, even though no evidence of the agency relationship appeared on the face of the filing. *Id.* at 348. In doing so, the court noted that

> the function of the financing statement is not compromised by this error. The financing statement places full and accurate notice of [the] security interest on the public record, thereby serving its intended purpose under the Uniform Commercial Code.

Id. at 349. The court also took judicial notice of the revision of the statute (effective July 1, 2001, after the events of this case) eliminating the debtor's signature as a requirement for perfection. *Id.*

Third, although North Carolina had not previously addressed the issue of a secured party's address[3], the courts have held that the address for the debtor in a financing statement need not be complete so long as it provides proper notice. *E-B Grain Co. v. Denton*, 73 N.C. App. 14, 325 S.E.2d 522, *rev. denied*, 313 N.C. 598, 330 S.E.2d 608 (1985).

In *E-B Grain*, defendant alleged that a financing statement did not contain the debtors' mailing address as

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[3] However, the issue has been decided by the Tenth Circuit in *Rooney v. Mason*, 394 F.2d 250 (10th Cir. 1968), which held perfected a security interest even though the filing did not include an address for the secured party or the debtor.

required by the statute and therefore the financing statement was defective. *Id.* at 21, 325 S.E.2d at 527. The debtors' address was listed as "Whitakers, N.C. 27891" on the financing statement. *Id.* The North Carolina Court of Appeals concluded that the debtors' mailing address was not so incomplete as to be misleading or interfere with the notice function of the filing, especially where the third party had regular business dealings with the debtors and would not have been prejudiced by any technical defects in the filing. *Id.* Thus, the court held that the filing was not defective.

Moreover, unlike the address for the debtor, a financing statement need only contain "an address for the secured party from which information concerning the security interest may be obtained." N.C.G.S. § 25-9-402(1) (1995). Thus, the requirement for the secured party's address is less stringent. In fact, the address requirement "is not to identify the secured party of record but rather to provide an address to which others can send required notifications. . . . " N.C.G.S. § 25-9-516, Comment. As the Fourth Circuit correctly observed, this requirement functions primarily to protect secured parties (Bonds) and not those dealing with the debtor (trustee). In keeping therewith, the Fourth Circuit previously held that information about the secured party (as opposed to the debtor) is less important to the purpose of the financing statement. *In re Bumper Sales, Inc.*, 907 F.2d 1430 (4th Cir. 1990).

In the present case, the financing statement at issue contained an address for BDI, where Bonds could be contacted, and provided another address for Bonds on the Cabarrus County filing. Therefore, the Fourth Circuit's opinion below is consistent with North Carolina state and

federal court precedent, and correctly held pursuant thereto that the financing statement put third parties on notice of the transaction, substantially complied with the statutory requirements, and was perfected. Accordingly, the petition for writ of certiorari should be denied.

III. Recent Amendments To The North Carolina Uniform Commercial Code Nullify Any Alleged Legal Import Of This Case.

Finally, the amendment of Article 9 of the Uniform Commercial Code by the North Carolina Legislature, effective July 1, 2001, renders this matter a dead issue. New Section 25-9-502 now governs the contents of a financing statement and requires for sufficiency only that the statement provide the name of the debtor, the name of the secured party or a representative of the secured party, and the collateral covered. N.C.G.S. § 25-9-502(a) (2001).[4] Any requirement for an address of either the debtor or the secured party has been eliminated.

In fact, the Comment to the new Section 25-9-506 governing the effect of errors or omissions explains that an error in even the name of the secured party (much less the address, which is no longer even required) will not be seriously misleading. N.C.G.S. § 25-9-506 (2001), Comment. Additionally, the Comment to new Section 25-9-516, listing grounds for which the filing office may refuse to

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[4] Section 25-9-502 now provides that a financing statement is sufficient if it "(1) Provides the name of the debtor; (2) Provides the name of the secured party or a representative of the secured party; and (3) Indicates the collateral covered by the financing statement."

accept a financing statement, states that the lack of an address for the secured party would not render a filed statement ineffective. N.C.G.S. § 25-9-516 (2001), Comment.

Therefore, under the current law, the financing statement at issue, having been accepted for filing by the filing office, would be perfected. Accordingly, the issue presented by the present case will never arise again, and thus this case lacks any legal significance. Even under prior law, however, the decision of the Fourth Circuit was correct. For these reasons as well, the petition for writ of certiorari should be denied.

CONCLUSION

For all the foregoing reasons, respondent William L. Mills, III respectfully requests that this Honorable Court deny the petition for writ of certiorari.

Respectfully submitted,

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